NETWORK APPLIANCE INC
Form 10-Q
September 05, 2007

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

Form 10-Q

(Mark One)

þ	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the quarterly period ended July 27, 2007**
	or
o	**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 0-27130
Network Appliance, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**77-0307520**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*

495 East Java Drive,
Sunnyvale, California 94089
(Address of principal executive offices, including zip code)

Registrant s telephone number, including area code:
(408) 822-6000

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 þ No o

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.

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

Number of shares outstanding of the registrant s common stock, $0.001 par value, as of the latest practicable date.

Class	Outstanding at August 24, 2007
Common Stock	355,820,070

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TRADEMARKS

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PART I. FINANCIAL INFORMATION

Item 1. ***Condensed Consolidated Financial Statements (Unaudited)***

NETWORK APPLIANCE, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands - Unaudited)

	July 27, 2007	April 27, 2007
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 623,990	$ 489,079
Short-term investments	706,270	819,702
Accounts receivable, net of allowances of $2,442 at July 27, 2007, and $2,572 at April 27, 2007	403,159	548,249
Inventories	58,019	54,880
Prepaid expenses and other assets	86,696	99,840
Short-term restricted cash and investments	103,906	118,312
Short-term deferred income taxes	106,810	110,741
Total current assets	2,088,850	2,240,803
Property and Equipment, Net	629,124	603,523
Goodwill	601,056	601,056
Intangible Assets, Net	76,115	83,009
Long-Term Restricted Cash and Investments	5,242	3,639
Long-Term Deferred Income Taxes and Other Assets	155,037	126,448
	$ 3,555,424	$ 3,658,478
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Current portion of long-term debt	$ 69,150	$ 85,110
Accounts payable	136,077	144,112
Income taxes payable	5,675	53,371
Accrued compensation and related benefits	107,377	177,327
Other accrued liabilities	89,887	97,017
Deferred revenue	663,865	630,610
Total current liabilities	1,072,031	1,187,547
Long-Term Deferred Revenue	485,970	472,423
Other Long-Term Obligations	70,288	9,487
	1,628,289	1,669,457

Stockholders Equity:				
Common stock (424,353 shares at July 27, 2007, and 421,623 shares at April 27, 2007)		424		422
Additional paid-in capital		2,479,063		2,380,623
Treasury stock at cost (61,115 shares at July 27, 2007, and 54,593 shares at April 27, 2007)		(1,823,691)		(1,623,691)
Retained earnings		1,260,502		1,226,165
Accumulated other comprehensive income		10,837		5,502
Total stockholders equity		1,927,135		1,989,021
	$	3,555,424	$	3,658,478

See accompanying notes to unaudited condensed consolidated financial statements.

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NETWORK APPLIANCE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts - Unaudited)

	Three Months Ended	
	July 27, 2007	July 28, 2006
Revenues		
Product	$ 463,333	$ 465,611
Software entitlements and maintenance	107,927	74,830
Service	117,975	80,847
Total revenues	689,235	621,288
Cost of Revenues		
Cost of product	186,751	187,965
Cost of software entitlements and maintenance	2,084	2,292
Cost of service	83,203	57,961
Total cost of revenues	272,038	248,218
Gross margin	417,197	373,070
Operating Expenses:		
Sales and marketing	244,643	195,518
Research and development	106,556	88,678
General and administrative	41,450	32,396
Restructuring recoveries		(74)
Total operating expenses	392,649	316,518
Income from Operations	24,548	56,552
Other Income (Expenses), Net:		
Interest income	17,035	16,656
Interest expense	(1,081)	(3,871)
Other income, net	832	779
Total other income, net	16,786	13,564
Income Before Income Taxes	41,334	70,116
Provision for Income Taxes	6,997	15,446
Net Income	$ 34,337	$ 54,670
Net Income per Share:		
Basic	$ 0.09	$ 0.15

Diluted	$	0.09	$	0.14
Shares Used in Net Income per Share Calculations:				
Basic		364,457		373,869
Diluted		377,631		391,319

See accompanying notes to unaudited condensed consolidated financial statements.

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NETWORK APPLIANCE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Three Months Ended	
	July 27, 2007	July 28, 2006
Cash Flows from Operating Activities:		
Net income	$ 34,337	$ 54,670
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	26,734	18,714
Amortization of intangible assets	6,398	4,686
Amortization of patents	495	495
Stock-based compensation	40,411	43,022
Loss on disposal of equipment	117	81
Allowance for doubtful accounts	84	144
Deferred income taxes	(17,803)	
Deferred rent	399	199
Excess tax benefit from stock-based compensation	(8,339)	(4,489)
Changes in assets and liabilities:		
Accounts receivable	188,072	69,914
Inventories	(3,145)	(520)
Prepaid expenses and other assets	(27,392)	(26,337)
Accounts payable	(14,082)	(1,139)
Income taxes payable	18,434	(6,914)
Accrued compensation and related benefits	(69,889)	(38,964)
Other accrued liabilities	(20,480)	(10,980)
Deferred revenue	46,548	61,982
Net cash provided by operating activities	200,899	164,564
Cash Flows from Investing Activities:		
Purchases of investments	(328,893)	(874,416)
Redemptions of investments	447,022	906,423
Redemptions of restricted investments	14,930	16,322
Change in restricted cash	(1,767)	252
Proceeds from sales of nonmarketable securities		17
Purchases of property and equipment	(33,586)	(23,056)
Purchases of nonmarketable securities	(4,035)	(1,183)
Net cash provided by investing activities	93,671	24,359
Cash Flows from Financing Activities:		
Proceeds from sale of common stock related to employee stock transactions	49,991	36,831
Excess tax benefit from stock-based compensation	8,339	4,489
Repayment of debt	(15,960)	(27,866)

Tax withholding payments reimbursed by restricted stock	(2,742)	(980)
Repurchases of common stock	(200,000)	(220,000)
Net cash used in financing activities	(160,372)	(207,526)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	713	(324)
Net Increase in Cash and Cash Equivalents	134,911	(18,927)
Cash and Cash Equivalents:		
Beginning of period	489,079	461,256
End of period	$ 623,990	$ 442,329
Noncash Investing and Financing Activities:		
Acquisition of property and equipment on account	$ 18,864	$ 6,524
Income tax benefit from employee stock transactions	20,702	29,987
Supplemental Cash Flow Information:		
Income taxes paid	$ 6,376	$ 22,453
Interest paid on debt	$ 1,075	$ 2,666

See accompanying notes to unaudited condensed consolidated financial statements.

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per-share data)
(Unaudited)

1. The Company

Based in Sunnyvale, California, Network Appliance was incorporated in California in April 1992 and reincorporated in Delaware in November 2001. Network Appliance, Inc. is a supplier of enterprise storage and data management software and hardware products and services. Our solutions help global enterprises meet major information technology challenges such as managing storage growth, assuring secure and timely information access, protecting data, and controlling costs by providing innovative solutions that simplify the complexity associated with managing corporate data. Network Appliance™ solutions are the data management and storage foundation for many of the world s leading corporations and government agencies.

2. Condensed Consolidated Financial Statements

The accompanying interim unaudited condensed consolidated financial statements have been prepared by Network Appliance, Inc. without audit and reflect all adjustments, consisting only of normal recurring adjustments which are, in the opinion of management, necessary for a fair presentation of our financial position, results of operations, and cash flows for the interim periods presented. The statements have been prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10-01 of Regulation S-X. Accordingly, they do not include all information and footnotes required by generally accepted accounting principles for annual consolidated financial statements.

In the first quarter of fiscal 2008, we began to classify sales-related tax receivable balances from our customers within prepaid expenses and other current assets. These balances were included in accounts receivable, net, in previous periods ($43,075 at April 27, 2007) and such amounts have been reclassified in the accompanying financial statements to conform to the current period classification. This reclassification had no effect on the reported amounts of net income or cash flow from operations for any period presented. In addition, we have chosen to use the term software entitlements and maintenance in our statements of income to describe the arrangements under which we provide our customers the right to receive unspecified software product upgrades and enhancements on a when-and-if-available basis, bug fixes and patch releases; these were previously described as software upgrade and maintenance arrangements.

We operate on a 52-week or 53-week year ending on the last Friday in April. The first quarters of fiscal 2007 and 2006 were both 13-week fiscal periods.

These financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended April 27, 2007. The results of operations for the quarter ended July 27, 2007, are not necessarily indicative of the operating results to be expected for the full fiscal year or future operating periods.

3. Use of Estimates

The preparation of the condensed consolidated financial statements is in conformity with generally accepted accounting principles and requires management to make estimates and assumptions that affect the reported amounts of

assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates include, but are not limited to, revenue recognition and allowances; allowance for doubtful accounts; valuation of goodwill and intangibles; fair value of derivative instruments and related hedged items; accounting for income taxes; inventory reserves and write-down; restructuring accruals; impairment losses on investments; fair value of options granted under our stock-based compensation plans; and loss contingencies. Actual results could differ from those estimates.

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Stock-Based Compensation, Equity Incentive Programs and Stockholders Equity

Effective April 29, 2006, we adopted the fair value recognition provision of Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payments* (SFAS No. 123R) under the modified prospective method.

Stock-Based Compensation Expense

The stock-based compensation expenses included in the Condensed Consolidated Statement of Income for the quarter ended July 27, 2007, and July 28, 2006, are as follows:

	Three Months Ended	
	July 27, 2007	July 28, 2006
Cost of product revenue	$ 945	$ 670
Cost of service revenue	2,671	2,634
Sales and marketing	17,491	18,717
Research and development	13,175	13,868
General and administrative	6,129	7,133
Total stock-based compensation expense before income taxes	40,411	43,022
Income taxes	(7,282)	(7,834)
Total stock-based compensation expense after income taxes	$ 33,129	$ 35,188

The following table summarizes stock-based compensation associated with each type of award:

	Three Months Ended	
	July 27, 2007	July 28, 2006
Employee stock options and awards	$ 36,529	$ 40,123
Employee stock purchase plan (ESPP)	3,876	3,383
Amounts capitalized in inventory	6	(484)
Total stock-based compensation expense before income taxes	40,411	43,022
Income taxes	(7,282)	(7,834)
Total stock-based compensation expense after income taxes	$ 33,129	$ 35,188

Income Tax Benefits Recorded in Stockholders Equity

For the first quarters of fiscal 2008 and 2007, the total income tax benefit associated with employee stock transactions was $20,702 and $29,987, respectively.

Income Tax Effects on Statements of Cash Flows

In accordance with SFAS No. 123R, we have presented tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options as financing cash flows. As such, the tax benefits related to tax deductions in excess of the compensation cost recognized, of $8,339 and $4,489 has been presented as financing cash flows for the first quarters of fiscal 2008 and fiscal 2007, respectively.

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Valuation Assumptions

In compliance with SFAS No. 123R, we estimated the fair value of stock options using the Black-Scholes model on the date of the grant. Assumptions used in the Black-Scholes valuation model were as follows:

	Stock Options Three Months Ended		ESPP Three Months Ended	
	July 27, 2007	**July 28, 2006**	**July 27, 2007**	**July 28, 2006**
Expected life in years(1)	4.0	4.0	0.5	0.5
Risk-free interest rate(2)	4.33% - 5.02%	4.79% - 5.05%	4.95%	5.02%
Volatility(3)	33% - 38%	35% - 36%	35%	37%
Expected dividend(4)	0%	0%	0%	0%

(1) The expected life of 4.0 years represented the period that our stock-option awards are expected to be outstanding and was determined based on historical experience on similar awards. The expected life of 0.5 years for the purchase plan was based on the term of the purchase period of the purchase plan.

(2) The risk-free interest rate for the options was based upon U.S. Treasury bills with equivalent expected terms of our employee stock-option award. The risk-free interest rate for the purchase plan was based upon U.S. Treasury bills yield curve in effect at the time of grant for the expected term of the purchase period.

(3) We used the implied volatility of traded options to estimate our stock price volatility.

(4) The expected dividend was determined based on our history and expected dividend payouts.

As required by SFAS No. 123R, we estimate our forfeiture rates based on historical voluntary termination behavior and recognized compensation expense only for those equity awards expected to vest.

Stock Options

A summary of the combined activity under our stock option plans and agreements is as follows:

	Shares Available for Grant	Outstanding Options Numbers of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at April 27, 2007	22,862	65,043	$ 29.28		

Options granted	(3,702)	3,702	31.93		
Restricted stock units granted	(68)	68			
Options exercised		(1,765)	14.95		
Restricted stock units exercised		(184)			
Options forfeitures and cancellation	966	(966)	37.88		
Restricted stock units forfeitures and cancellation	27	(27)			
Options expired	(48)				
Outstanding at July 27, 2007	20,037	65,871	$ 29.75		
Options vested and expected to vest as of July 27, 2007		61,943	$ 30.22	5.49	$ 338,731
Exercisable at July 27, 2007		39,523	$ 29.01	4.59	$ 306,707
RSUs vested and expected to vest as of July 27, 2007		1,148	$	1.85	$ 33,573
Exercisable at July 27, 2007			$		$

The intrinsic value represents the difference between the exercise price of stock options and the market price of our stock on that day for all in-the-money options. The weighted-average fair value for the first quarter fiscal 2008

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

grants as of the grant date was $10.76. The total intrinsic value of options exercised was $32,619 and $26,382 for the first quarters of fiscal 2008 and 2007, respectively. We received $26,395 and $19,320 from the exercise of stock options for the first quarters of fiscal 2008 and 2007, respectively.

The following table summarizes our nonvested shares (restricted stock awards) as of July 27, 2007:

	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested at April 27, 2007	265	$ 34.45
Awards granted		
Awards vested	(20)	27.86
Awards canceled/expired/forfeited	(30)	34.85
Nonvested at July 27, 2007	215	$ 35.01

Although nonvested shares are legally issued, they are considered contingently returnable shares subject to repurchase by the Company when employees terminate their employment. The total fair value of shares vested during the first quarters of fiscal 2008 and 2007 was $585 and $1,516, respectively. There was $45,755 of total unrecognized compensation as of July 27, 2007 related to restricted stock awards. The unrecognized compensation will be amortized on a straight-line basis over a weighted-average period of 2.9 years.

Employee Stock Purchase Plan

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at July 27, 2007	1,068	$ 26.13	0.35	$ 3,324
Vested and expected to vest at July 27, 2007	1,037	$ 26.13	0.35	$ 3,226

The total intrinsic value of employee stock purchases was $5,044 and $10,942 for the first quarters of fiscal 2008 and 2007, respectively. The compensation cost for options purchased under the ESPP plan was $3,876 and $3,383 for the first quarters of fiscal 2008 and 2007, respectively. This compensation cost will be amortized on a straight-line basis over a weighted-average period of approximately 0.35 years.

The following table shows the shares issued and their purchase price per share for the employee stock purchase plan for the six-month period ended May 31, 2007:

Purchase Date	**May 31, 2007**
Shares issued	891
Average purchase price per share	$ 26.50

Stock Repurchase Program

Common stock repurchase activities for the quarter ended July 27, 2007, and July 28, 2006, were as follows:

	Three Months Ended	
	July 27, 2007	**July 28, 2006**
Common stock repurchased	6,522	6,561
Cost of common stock repurchased	$ 200,000	$ 220,000
Average price per share	$ 30.67	$ 33.53

NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Since the inception of the stock repurchase program through July 27, 2007, we have purchased a total of 61,115 shares of our common stock at an average price of $29.84 per share for an aggregate purchase price of $1,823,691. At July 27, 2007, $199,948 remained available for repurchases under the plan. The stock repurchase program may be suspended or discontinued at any time.

5. Debt

On March 31, 2006, Network Appliance Global LTD. (Global), a subsidiary of the Company, entered into a loan agreement (the Loan Agreement), with the lenders and JPMorgan Chase Bank, National Association, as administrative agent. The Loan Agreement provides for a term loan available in two tranches, a tranche of $220,000 (Tranche A) and a tranche of $80,000 (Tranche B), for an aggregate borrowing of $300,000. The proceeds of the term loan have been used to finance a dividend from Global to the Company under the American Jobs Creation Act. The Tranche A term loan, together with accrued and unpaid interest, is due in full on the maturity date of March 31, 2008. During the three-month period ended July 27, 2007, we made repayments of $15,960 on the term loan. The Tranche A term loan is secured by certain investments totaling $101,467 as of July 27, 2007, held by Global. The Tranche B term loan was fully repaid as of January 26, 2007. Loan repayments of $69,150 are due in the remainder of fiscal 2008.

Interest for the Tranche A term loan accrues at a floating rate based on the base rate in effect from time to time, plus a margin, which totaled 5.45% at July 27, 2007.

As of July 27, 2007, Global was in compliance with all debt covenants as required by the Loan Agreement.

6. Short-Term Investments

The following is a summary of investments at July 27, 2007:

	Amortized Cost	Gross Unrealized Gains	Losses	Estimated Fair Value
Corporate bonds	$ 548,182	$ 218	$ 1,682	$ 546,718
Corporate securities	114,669	34	5	114,698
Auction rate securities	39,682			39,682
U.S. government agencies	181,109	15	391	180,733
U.S. Treasuries	10,103		63	10,040
Municipal bonds	2,769			2,769
Marketable equity securities	4,637	13,194		17,831
Money market funds	33,440			33,440
Total debt and equity securities	934,591	13,461	2,141	945,911
Less cash equivalents	138,139	35		138,174
Less short-term restricted investments	102,020		553	101,467(1)

Short-term investments	$ 694,432	$ 13,426	$ 1,588	$ 706,270

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following is a summary of investments at April 27, 2007:

	Amortized Cost	Gross Unrealized Gains	Losses	Estimated Fair Value
Corporate bonds	$ 544,334	$ 398	$ 1,484	$ 543,248
Auction rate securities	114,415			114,415
Corporate securities	113,084	24	7	113,101
U.S. government agencies	218,492	12	753	217,751
U.S. Treasuries	10,097		112	9,985
Municipal bonds	3,769		11	3,758
Marketable equity securities	4,637	8,276		12,913
Money market funds	84,961			84,961
Total debt and equity securities	1,093,789	8,710	2,367	1,100,132
Less cash equivalents	164,347	23		164,370
Less short-term restricted investments	116,950		890	116,060(2)
Short-term investments	$ 812,492	$ 8,687	$ 1,477	$ 819,702

(1) As of July 27, 2007, we have pledged $101,467 of short-term restricted investments for the Tranche A term loan as defined in the Loan Agreement (see Note 5). In addition, we have short-term and long-term restricted cash of $2,439 and $5,242, respectively, relating to our foreign rent, custom, and service performance guarantees. These combined amounts are presented as short-term and long-term restricted cash and investments in the accompanying Condensed Consolidated Balance Sheets as of July 27, 2007.

(2) As of April 27, 2007, we have pledged $116,060 of short-term restricted investments for the Tranche A term loan as defined in the Loan Agreement (see Note 5). In addition, we have short-term and long-term restricted cash of $2,252 and $3,639, respectively, relating to our foreign rent, custom, and service performance guarantees. These combined amounts are presented as short-term and long-term restricted cash and investments in the accompanying Condensed Consolidated Balance Sheets as of April 27, 2007.

Marketable equity securities consisted of 360 shares of common stock in Blue Coat Systems, Inc. (Blue Coat) received in connection with the sale of assets of NetCache®. On August 13, 2007, we sold all of these shares of common stock of Blue Coat and received net proceeds of approximately $18,256. (See Note 16.)

We record net unrealized gains or losses on available-for-sale securities in stockholders equity. Realized gains or losses are reflected in income which have not been material for all years presented. The following table shows the gross unrealized losses and fair values of our investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at July 27, 2007:

	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate bonds	$ 198,030	$ (768)	$ 195,543	$ (914)	$ 393,573	$ (1,682)
Corporate securities	4,973	(5)			4,973	(5)
U.S. government agencies	66,983	(252)	76,803	(139)	143,786	(391)
U.S. treasury	10,040	(63)			10,040	(63)
Total	$ 280,026	$ (1,088)	$ 272,346	$ (1,053)	$ 552,372	$ (2,141)

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The unrealized losses on our investments in Corporate Bonds and U.S. government agencies were caused by interest rate increases. We believe that we will be able to collect all principal and interest amounts due to us at maturity given the high credit quality of these investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because we have the ability and intent to hold those investments until a recovery of fair value, which may be maturity, we do not consider these investments to be other-than temporarily impaired at July 27, 2007.

7. Inventories

Inventories are stated at the lower of cost (first-in, first-out basis) or market. Inventories consist of the following:

	July 27, 2007	April 27, 2007
Purchased components	$ 18,096	$ 19,429
Work-in-process	1,280	5
Finished goods	38,643	35,446
	$ 58,019	$ 54,880

8. Goodwill and Intangible Assets

Under SFAS No. 142, *Goodwill and Other Intangible Assets,* goodwill attributable to each of our reporting units is required to be tested for impairment by comparing the fair value of each reporting unit with its carrying value. Our reporting units are the same as our operating units. Goodwill is reviewed annually for impairment (or more frequently if indicators of impairment arise). As of July 27, 2007, and April 27, 2007, respectively, there had been no impairment of goodwill and intangible assets.

Intangible assets are summarized as follows:

		July 27, 2007			April 27, 2007		
	Amortization Period (Years)	Gross Assets	Accumulated Amortization	Net Assets	Gross Assets	Accumulated Amortization	Net Assets
				(In thousands)			
Intangible Assets:							
Patents	5	$ 10,040	$ (7,925)	$ 2,115	$ 10,040	$ (7,429)	$ 2,611
Existing technology	4 - 5	113,625	(55,156)	58,469	113,625	(49,878)	63,747
Trademarks/tradenames	2 - 6	5,280	(1,876)	3,404	5,280	(1,651)	3,629
Customer Contracts/relationships	1.5 - 6	17,220	(5,143)	12,077	17,220	(4,398)	12,822
Covenants Not to Compete	1.5 - 2	9,510	(9,460)	50	9,510	(9,310)	200

Total Intangible Assets, Net	$	155,675	$	(79,560)	$	76,115	$	155,675	$	(72,666)	$	83,009

Amortization expense for identified intangible assets is summarized below:

	Three Months Ended			
	July 27, 2007		July 28, 2006	
Patents	$	495	$	495
Existing technology		5,278		3,866
Other identified intangibles		1,121		821
	$	6,894	$	5,182

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Based on the identified intangible assets recorded at July 27, 2007, the future amortization expense of identified intangibles for the remainder of fiscal 2008 and the next four fiscal years and thereafter is as follows:

Year Ending April,		Amount (In thousands)
2008	$	20,282
2009		24,665
2010		19,694
2011		8,987
2012		1,633
Thereafter		854
Total	$	76,115

9. Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, and restricted cash and investments reported in the Condensed Consolidated Balance Sheets approximate their fair value. Our short-term investments and foreign exchange contracts are carried at fair value based on quoted market prices. Other investments in nonmarketable securities are included in other assets at July 27, 2007, and April 27, 2007, with total carrying value of $12,948 and $8,932, which approximate their fair values. The fair value of our debt also approximates its carrying value as of July 27, 2007, and April 27, 2007.

We do not use derivative financial instruments for speculative or trading purposes. We enter into forward foreign exchange and currency option contracts to hedge trade and intercompany receivables and payables as well as future sales and operating expenses against future movement in foreign exchange rates.

Foreign currency forward contracts obligate us to buy or sell foreign currencies at a specified future date. Option contracts give us the right to buy or sell foreign currencies and are exercised only when economically beneficial. As of July 27, 2007, we had $336,126 of outstanding foreign exchange contracts (including $22,444 of option contracts) as indicated below that all had remaining maturities of five months or less. As of April 27, 2007, we had $367,479 of outstanding foreign exchange contracts (including $21,703 of option contracts). For the balance sheet hedges, these contracts are adjusted to fair value at the end of each month and are included in earnings. The premiums paid on the foreign currency option contracts are recognized as a reduction to other income when the contract is entered into. For cash flow hedges, the related gains or losses are included in other comprehensive income. Gains and losses on these foreign exchange contracts are offset by losses and gains on the underlying assets and liabilities. At July 27, 2007, and April 27, 2007 the estimated notional fair values of forward foreign exchange contracts were $335,700 and $368,807, respectively. The fair value of foreign exchange contracts is based on prevailing financial market information. For the quarter ended July 27, 2007, net gains generated by hedged assets and liabilities totaled $681 and were offset by losses on the related derivative instruments of $70.

10. Net Income Per Share

During all periods presented, we had certain options outstanding, which could potentially dilute basic earnings per share in the future, but were excluded in the computation of diluted earnings per share in such periods, as their effect would have been antidilutive. These certain options were antidilutive in the quarters ended July 27, 2007, and July 28, 2006, as these options exercise prices were above the average market prices in such periods. For quarters ended July 27, 2007, and July 28, 2006, 30,402 and 25,857 shares of common stock options with a weighted average exercise price of $42.57 and $42.72, respectively, were excluded from the diluted net income per share computation.

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations for the periods presented:

	Three Months Ended	
	July 27, 2007	July 28, 2006
Net Income (Numerator):		
Net income, basic and diluted	$ 34,337	$ 54,670
Shares (Denominator):		
Weighted average common shares outstanding	364,713	374,315
Weighted average common shares outstanding subject to repurchase	(256)	(446)
Shares used in basic computation	364,457	373,869
Weighted average common shares outstanding subject to repurchase	256	446
Common shares issuable upon exercise of stock options	12,918	17,004
Shares used in diluted computation	377,631	391,319
Net Income per Share:		
Basic	$ 0.09	$ 0.15
Diluted	$ 0.09	$ 0.14

Basic net income per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding excluding unvested restricted stock for that period. Diluted net income per share is computed giving effect to all dilutive potential shares that were outstanding during the period. Dilutive potential common shares consist of incremental common shares subject to repurchase, common shares issuable upon exercise of stock options, and restricted stock awards.

11. Comprehensive Income

The components of comprehensive income were as follows:

	Three Months Ended	
	July 27, 2007	July 28, 2006
Net income	$ 34,337	$ 54,670
Currency translation adjustment	448	651

Unrealized gain on available-for-sale investments, net of related tax effect	1,046	1,741
Unrealized gain on derivatives	3,841	968
Comprehensive income	$ 39,672	$ 58,030

The components of accumulated other comprehensive income were as follows:

	July 27, 2007	April 27, 2007
Accumulated translation adjustments	$ 3,769	$ 3,321
Accumulated unrealized gain on available-for-sale investments	6,515	5,469
Accumulated unrealized gain (loss) on derivatives	553	(3,288)
Total accumulated other comprehensive loss	$ 10,837	$ 5,502

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Restructuring Charges

In fiscal 2002, as a result of continuing unfavorable economic conditions and a reduction in information technology (IT) spending rates, we implemented two restructuring plans, which included reductions in our workforce and consolidations of our facilities. As of July 27, 2007, we have no outstanding balance in our restructuring liability for the first restructuring. The second restructuring related to the closure of an engineering facility and consolidation of resources to the Sunnyvale headquarters. In fiscal 2006, we implemented a third restructuring plan related to the move of our global services center operations from Sunnyvale to our new flagship support center at our Research Triangle Park facility in North Carolina. Of the reserve balance at July 27, 2007, $542 was included in other accrued liabilities, and the remaining $1,389 was classified as long-term obligations.

Our restructuring estimates are reviewed and revised periodically and may result in a substantial charge or reduction to restructuring expense should different conditions prevail than were anticipated in previous management estimates. Such estimates included various assumptions such as the time period over which the facilities will be vacant, expected sublease terms, and expected sublease rates. During the quarter ended July 27, 2007, we did not record any reduction or charges in the restructuring reserve.

	Facility	Severance-Related Amounts	Total
Reserve balance at April 28, 2006	$ 2,666	$ 338	$ 3,004
Recoveries		(74)	(74)
Cash payments and other	(582)	(264)	(846)
Reserve balance at April 27, 2007	$ 2,084		$ 2,084
Recoveries			
Cash payments and other	(153)		(153)
Reserve balance at July 27, 2007	$ 1,931	$	$ 1,931

13. Commitments and Contingencies

The following summarizes our commitments and contingencies at July 27, 2007, and the effect such obligations may have on our future periods:

	2008	2009	2010	2011	2012	Thereafter	Total
Contractual Obligations:							
Office operating lease payments(1)	$ 18,226	$ 23,948	$ 24,391	$ 17,970	$ 12,568	$ 29,680	$ 126,783

Real estate lease payments(2)	925	7,579	9,981	9,981	9,981	162,110	200,557
Equipment operating lease payments(3)	8,746	10,065	4,737	187			23,735
Venture capital funding commitments(4)	212	270	257	245	20		1,004
Capital expenditures(5)	13,023	4,296					17,319
Communications and maintenance(6)	14,318	15,881	8,493	1,521	138		40,351
Total Contractual Cash Obligations	$ 55,450	$ 62,039	$ 47,859	$ 29,904	$ 22,707	$ 191,790	$ 409,749
Other Commercial Commitments:							
Letters of credit(7)	$ 2,709	$ 310	$	$	$	$ 437	$ 3,456

(1) We lease sales offices and research and development facilities throughout the United States and internationally. These sales offices are leased under operating leases which expire through fiscal 2016. We are responsible for certain maintenance costs, taxes, and insurance under these leases. Substantially all lease agreements have fixed

NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

payment terms based on the passage of time. Some lease agreements provide us with the option to renew or terminate the lease. Our future operating lease obligations would change if we were to exercise these options and if we were to enter into additional operating lease agreements. Rent operating lease payments in the table exclude lease payments which are accrued as part of our fiscal 2002 restructurings and include only rent lease commitments that are over one year.

(2) Included in the above contractual cash obligations pursuant to three financing arrangements with BNP Paribas LLC (BNP) are (a) lease commitments of $925 in fiscal 2008; $7,579 in fiscal 2009, $9,981 in each of the fiscal years 2010, 2011, and 2012, $9,057 in fiscal 2013; and $4,729 in fiscal 2014 which are based on the LIBOR rate at July 27, 2007, for a term of five years, and (b) at the expiration or termination of the lease, a supplemental payment obligation equal to our minimum guarantee of $148,324 in the event that we elect not to purchase or arrange for sale of the buildings.

(3) Equipment operating leases include servers and IT equipment used in our engineering labs and data centers.

(4) Venture capital funding commitments include a quarterly committed management fee based on a percentage of our committed funding to be payable through June 2011.

(5) Capital expenditures include worldwide contractual commitments to purchase equipment and to construct building and leasehold improvements, which will be recorded as Property and Equipment.

(6) We are required to pay based on a minimum volume under certain communication contracts with major telecommunication companies as well as maintenance contracts with multiple vendors. Such obligations will expire in November 2011.

(7) The amounts outstanding under these letters of credit relate to workers compensation, a customs guarantee, a corporate credit card program, and a foreign rent guarantee.

As of July 27, 2007, we had entered into two financing, construction, and leasing arrangements with BNP for office space to be located on land currently owned by us in Sunnyvale, California. These arrangements require us to lease our land to BNP for a period of 50 years to construct approximately 380,000 square feet of office space costing up to $113,500. After completion of construction, we will pay minimum lease payments, which vary based on the London Interbank Offered Rate (LIBOR) plus a spread (5.72% at July 27, 2007) on the cost of the facilities. We expect to begin making lease payments on the completed buildings in January and September 2008 for terms of five years. We have the option to renew the leases for two consecutive five-year periods upon approval by BNP. Upon expiration (or upon any earlier termination) of the lease terms, we must elect one of the following options: We may (i) purchase the buildings from BNP for $48,500 and $65,000, respectively; (ii) if certain conditions are met, arrange for the sale of the buildings by BNP to a third party for an amount equal to at least $41,225 and $55,250, respectively, and be liable for any deficiency between the net proceeds received from the third party and such amounts; or (iii) pay BNP supplemental payments of $41,225 and $55,250, respectively, in which event we may recoup some or all of such payment by arranging for a sale of either or both buildings by BNP during the ensuing two-year period.

On July 17, 2007, we entered into additional financing, construction, and leasing arrangements with BNP for facility space to be located on land currently owned by us in Research Triangle Park, North Carolina. These arrangements

require us to lease our land to BNP for a period of 99 years to construct approximately 120,000 square feet of data center costing up to $61,000. After completion of construction, we will pay minimum lease payments, which vary based on LIBOR plus a spread (5.72% at July 27, 2007) on the cost of the facility. We expect to begin making lease payments on the completed buildings in September 2008 for a term of five and half years. We have the option to renew the lease for two consecutive five-year periods upon approval by BNP. Upon expiration (or upon any earlier termination) of the lease term, we must elect one of the following options: We may (i) purchase the building from BNP for $61,000; (ii) if certain conditions are met, arrange for the sale of the building by BNP to a third party for an amount equal to at least $51,850, and be liable for any deficiency between the net proceeds received from the third party and $51,850; or (iii) pay BNP a supplemental payment of $51,850, in which event we

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

may recoup some or all of such payment by arranging for a sale of the building by BNP during the ensuing two-year period.

All leases require us to maintain specified financial covenants with which we were in compliance as of July 27, 2007. Such specified financial covenants include a maximum ratio of Total Debt to Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) and a Minimum Unencumbered Cash and Short Term Investments.

As of July 27, 2007, the notional fair value of our foreign exchange forward and foreign currency option contracts totaled $335,700. We do not believe that these derivatives present significant credit risks, because the counterparties to the derivatives consist of major financial institutions, and we manage the notional amount of contracts entered into with any one counterparty. We do not enter into derivative financial instruments for speculative or trading purposes. Other than the risk associated with the financial condition of the counterparties, our maximum exposure related to foreign currency forward and option contracts is limited to the premiums paid on purchased options only.

We have both recourse and nonrecourse lease financing arrangements with third-party leasing companies through preexisting relationships with the customers. We sell our products directly to the leasing company, and the lease arrangement is made between our customer and the leasing company. Under the terms of recourse leases, which are generally three years or less, we remain liable for the aggregate unpaid remaining lease payments to the third-party leasing company in the event that any customers default. For these recourse arrangements, revenues on the sale of our product to the leasing company are deferred and recognized into income as payments to the leasing company come due. As of July 27, 2007, and April 27, 2007, the maximum recourse exposure under such leases totaled approximately $11,831 and $10,262, respectively. Under the terms of the nonrecourse leases, we do not have any continuing obligations or liabilities. To date, we have not experienced significant losses under this lease financing program.

From time to time, we have committed to purchase various key components used in the manufacture of our products. We establish accruals for estimated losses on purchased components for which we believe it is probable that they will not be utilized in future operations. To the extent that such forecasts are not achieved, our commitments and associated accruals may change.

In addition, we are subject to various legal proceedings and claims which may arise in the normal course of business. While the outcome of these legal matters is currently not determinable, we do not believe that any current litigation or claims will have a material adverse effect on our business, cash flow, operating results, or financial condition.

We are currently undergoing federal income tax audits in the United States and several foreign tax jurisdictions. The rights to some of our intellectual property (IP) are owned by certain of our foreign subsidiaries, and payments are made between foreign and U.S. tax jurisdictions relating to the use of this IP. Recently, some other companies have had their foreign IP arrangements challenged as part of an examination. Our management does not believe, based upon information currently known to us, that the final resolution of any of our audits will have a material adverse effect upon our consolidated financial position and the results of operations and cash flows. However, if upon the conclusion of these audits the ultimate determination of our taxes owed in any of these tax jurisdictions is for an amount in excess of the tax provision we have recorded or reserved for, our overall effective tax rate may be adversely impacted in the period of adjustment.

The General Services Administration (GSA) is currently auditing our records under the schedule contracts it had with us to verify our compliance with various contract provisions. If the audit determines that we did not comply with such provisions, we may be required to pay the GSA a potential settlement. The exact date for completion of the audit and the subsequent negotiation process is unknown and may not be concluded for some time. Our management does not believe, based upon information currently known to us, that the final resolution of our audit will have a material adverse effect upon our consolidated financial position and the results of operations and cash flows.

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Income Taxes

In June 2006, the FASB issued FIN No. 48, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition.

The total amount of unrecognized tax benefits upon the adoption of FIN No. 48, on April 28, 2007, was $58,326. There was no cumulative effect from the adoption of FIN No. 48, however, certain amounts were reclassified among our consolidated balance sheet accounts as follows:

Retained earnings cumulative effect	$
Additional deferred tax assets	4,889
Reclass from current liability to long term liability	53,437
Total increase in liability	$ 58,326

The entire portion of the $58,326 balance of unrecognized tax benefits at April 28, 2007, if recognized, would affect our effective tax rate.

We recognize accrued interest and penalties related to unrecognized tax benefits in the income tax provision. During the fiscal years ended 2005-2007, we recognized total accrued interest and penalties of approximately $170 and have included this accrual in our FIN No. 48 disclosure balances.

We are subject to taxation in the United States, various states and several foreign jurisdictions. Our federal income tax returns are currently being examined for the fiscal years 2003-2004. We are effectively subject to federal tax examination adjustments for tax years ending on or after fiscal year 2000, in that we have net operating loss carryforwards from these years that could be subject to adjustment, if and when utilized.

As we are in the early stages of the federal tax return and foreign jurisdiction audit process, at this time we can not make a determination as to whether or not recognition of any unrecognized tax benefits will occur within the next 12 months.

The tax years that remain subject to examination for our major tax jurisdictions are shown below:

Tax Years Subject to Examination for Major Tax Jurisdictions at July 27, 2007

2003	2007	United States	federal income tax
2002	2007	United States	state and local income tax
2003	2007	Australia	

2005	2007	France
2004	2007	Germany
2005	2007	India
2006	2007	Japan
2000	2007	The Netherlands
2004	2007	United Kingdom

The above table excludes the net operating loss carryover risk identified above with respect to federal and state tax returns.

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NETWORK APPLIANCE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. New Accounting Pronouncements

Effective April 28, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN No. 48). FIN No. 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that we have taken or expect to take on a tax return (including a decision whether to file or not to file a return in a particular jurisdiction). FIN No. 48 is applicable to all uncertain tax positions for taxes accounted for under FASB Statement No. 109, *Accounting for Income Taxes* (SFAS No. 109), and substantially changes the applicable accounting model. There was no cumulative effective from the adoption of FIN No. 48. As a result of the implementation of FIN No. 48, we recognize the tax liability for uncertain income tax positions on the income tax return based on the two-step process prescribed in the interpretation. The first step is to determine whether it is more likely than not that each income tax position would be sustained upon audit. The second step is to estimate and measure the tax benefit as the amount that has a greater than 50% likelihood of being realized upon ultimate settlement with the tax authority. Estimating these amounts requires us to determine the probability of various possible outcomes. We evaluate these uncertain tax positions on a quarterly basis. See Note 14, Income Taxes, for further discussion.

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115.* SFAS No. 159 allows measurement at fair value of eligible financial assets and liabilities that are not otherwise measured at fair value. If the fair value option for an eligible item is elected, unrealized gains and losses for that item shall be reported in current earnings at each subsequent reporting date. SFAS No. 159 also establishes presentation and disclosure requirements designed to draw comparison between the different measurement attributes the company elects for similar types of assets and liabilities. This statement is effective the first quarter of fiscal 2009. We are currently evaluating the effect, if any, that the adoption of SFAS No. 159 will have on our consolidated financial statements.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements.* SFAS No. 157 provides a framework for measuring fair value, clarifies the definition of fair value, and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements and eliminates inconsistencies in guidance found in various prior accounting pronouncements. We are required to adopt SFAS No. 157 in the first quarter of fiscal 2009. We are currently evaluating the effect that the adoption of SFAS No. 157 will have on our consolidated results of operations and financial condition, but do not expect it to have a material impact.

16. Subsequent Events

On August 13, 2007, we sold 360 shares of common stock of Blue Coat in a private transaction pursuant to Rule 144 under the Securities Act of 1933. We received net proceeds of approximately $18,256, after deducting the purchaser s discount. These shares were acquired on September 11, 2006, in connection with the sale of our NetCache assets to Blue Coat.

On August 14, 2007, the Board of Directors approved a new stock repurchase program in which up to $1,000,000 worth of additional common stock may be purchased in addition to $199,948 remaining from all prior authorizations. On August 20, 2007, we repurchased $225,000 in common stock pursuant to our existing and new stock repurchase

programs.

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and is subject to the safe harbor provisions set forth in the Exchange Act. Forward-looking statements usually contain the words estimate, intend, plan, predict, seek, may, will, should, would, anticipate similar expressions and variations or negatives of these words. In addition, any statements that refer to expectations, projections, or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. All forward-looking statements, including, but not limited to, (1) the continued softness in enterprise storage spending; (2) our programs to develop more new accounts; (3) our intention to continue to penetrate the largest storage buyers; (4) our plan to restrict discretionary expense; (5) our business fundamentals, our confidence in the competitiveness of our products, and our ability to grow our business over the long term; (6) our plan to invest in the people, processes and systems necessary to best optimize our revenue growth; our belief that we are well positioned in the fastest growth segments of the storage market; (7) higher disk content associated with high-end and mid-range storage systems and its impact on our gross margin in the future; (8) our service margin may experience some variability; (9) our estimate of the impact that adopting SFAS No. 123R will have on our earnings per share; (10) our estimates of future amortization of patents, trademarks, tradenames, customer contracts, and relationships; (11) our expectation to continue to selectively add sales capacity in an effort to expand domestic and international markets; (12) our expectation that our sales and marketing expenses will increase commensurate with future revenue growth; (13) our future performance will depend in large part on our ability to maintain and enhance our current product line, develop new products that achieve market acceptance, maintain technological competitiveness, and meet an expanding range of customer requirements; (14) our expectation to continuously support current and future product development and enhancement efforts and to incur corresponding charges; (15) our intention to continuously broaden our existing product offerings and introduce new products; (16) our belief regarding our research and development and general and administrative expenses will increase in absolute dollars for the remainder of fiscal 2008; (17) our estimates regarding future amortization of covenants not to compete; (18) our expectation that interest income may vary; (19) period-to-period changes in foreign exchange gains or losses will continue to be impacted by hedging costs associated with our forward and option activities and forecast variance; (20) our expectation that cash provided by operating activities may fluctuate in future periods; (21) the possibility we may receive less cash from stock option exercises if stock option exercise patterns change; (22) our expectations regarding our contractual cash obligations and other commercial commitments at July 27, 2007, for future periods; (23) our expectation regarding the complete construction of our building under the BNP lease and the estimates regarding future minimum lease payments under the lease term; (24) our expectation that capital expenditures will increase consistent with our business growth; (25) our expectation that our existing facilities and those currently being developed will be sufficient for our needs for at least the next two years and that our contractual commitments, and any required capital expenditures over the next few years, will be funded through cash from operations and existing cash and investments; (26) our expectation that we will incur higher capital expenditures in the near future; (27) our belief that our cash and cash equivalents, short-term investments, and cash generated from operations will satisfy our working capital needs, capital expenditures, stock repurchases, contractual obligations, and other liquidity requirements associated with our operations through at least the next 12 months; (28) our belief that, based upon information available to us, that any current litigation and claims including our audits will not have a material adverse impact on our operating results; and (29) our belief that the results of our GSA and income tax audits will not have a materially adverse effect on us are inherently uncertain as they are based on management s current expectations and assumptions concerning future events, and they are subject to numerous known and unknown risks and uncertainties. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof and are based upon information available to us at this time. These statements are not guarantees of future performance. We disclaim any obligation to update information in any forward-looking statement.

First Quarter Fiscal 2008 Overview

Revenues for the first quarter of fiscal 2008 were $689.2 million, reflecting an increase of 10.9% year over year but a decreased of 14.0% sequentially over the previous quarter. We believe the principal factor impacting our

revenue was the continued softness in enterprise storage spending, most notably in our existing commercial enterprise customer accounts in the United States and parts of Europe. The slowdown was not across all geographies and verticals. We reported increased revenue from the Federal business and regions such as Northeast Europe and Asia Pacific.

While we are not immune to the macroeconomic environment that is beyond our control, we believe that we are well positioned in the fastest growth segments of the storage market to capitalize on an IT spending recovery. We will continue to expand our programs to develop more new accounts, deepen our penetration in our current enterprise accounts, and broaden our vertical coverage. We intend to accelerate our revenue growth by penetrating the largest buyers of storage in the world, and will continue to invest in go-to-market partnerships, specifically through our channel programs and partnerships. At the same time, we will continue to restrict discretionary expense and slow down the rate of hiring in order to return to our targeted business model. However, if any storage market trends and emerging standards on which we are basing our assumptions do not materialize as anticipated, and if there is reduced or no demand for our products, our expected revenue growth rate could be materially affected.

Despite the revenue decrease from the fourth quarter of fiscal 2007, we believe our business fundamentals remain intact, and we are confident in the competitiveness of our products and in our ability to grow our business over the long term. We do not believe that this shortfall is the result of changes in the competitive environment. However, continued revenue growth depends on the introduction and market acceptance of our new products and solutions and continued market demand for our products. We will continue to invest in the people, processes, and systems necessary to best optimize our revenue growth and long-term profitability. However, we cannot assure you that such investments will achieve our financial objectives.

First Quarter Fiscal 2008 Financial Performance

Our revenues for the first quarter of fiscal 2008 were $689.2 million, a 10.9% increase over the same period a year ago, however, a decrease of 14.0% from the immediate preceding quarter. Our year-over-year revenue growth was driven by an increase in software entitlements and maintenance revenue, and an increase in service revenue.

Our overall gross margin increased to 60.5% in the first quarter of fiscal 2008 from 60.0% in the same period a year ago. The increase in our gross margin was primarily attributable to higher margin associated with the increased revenue from software entitlements and maintenance and a higher add-on software mix and improved service margin.

In the first quarter of fiscal 2008, we generated $200.9 million of cash from operating activities as compared to $164.6 million in the first quarter of fiscal 2007. As of July 27, 2007, our cash, cash equivalents, and short-term investments increased to $1,330.3 million, compared to $1,308.8 million as of April 27, 2007. This increase was due primarily to cash generated from operations, partially offset by $200.0 million used to repurchase our common stock. Our deferred revenue increased sequentially by 4.3% to $1,149.8 million as of July 27, 2007, from $1,103.0 million reported as of April 27, 2007, reflecting the timing of software entitlements and maintenance and service revenue recognition. Capital purchases of plant, property, and equipment for the first quarters of fiscal 2008 and 2007 were $33.6 million and $23.1 million, respectively, reflecting continued worldwide capital investment to meet our business growth.

Critical Accounting Estimates and Policies

Our discussion and analysis of financial condition and results of operations are based upon our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United

States of America. The preparation of such statements requires us to make estimates and assumptions that affect the reported amounts of revenues and expenses during the reporting period and the reported amounts of assets and liabilities as of the date of the financial statements. Our estimates are based on historical experience and other assumptions that we consider to be appropriate in the circumstances. However, actual future results may vary from our estimates.

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With the exception of the changes required by FIN No. 48 on Accounting for Income Taxes, there have been no significant changes during the first quarter of fiscal 2008 to the items that we disclosed as our critical accounting policies and estimates in the Management s Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended April 27, 2007.

Accounting for Income Taxes

The determination of our tax provision is subject to judgments and estimates due to the complexity of the tax law that we are subject to in several tax jurisdictions. Earnings derived from our international business are generally taxed at rates that are lower than U.S. rates, resulting in a lower effective tax rate than the U.S. statutory tax rate of 35.0%. The ability to maintain our current effective tax rate is contingent on existing tax laws in both the United States and the respective countries in which our international subsidiaries are located. Future changes in domestic or international tax laws could affect the continued realization of the tax benefits we are currently receiving. In addition, a decrease in the percentage of our total earnings from our international business or a change in the mix of international business among particular tax jurisdictions could increase our overall effective tax rate.

We account for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes.* SFAS No. 109 requires that deferred tax assets and liabilities be recognized for the effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. SFAS No. 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some or all of the deferred tax asset will not be realized. We have provided a valuation allowance of $21.0 million as of July 27, 2007, compared to $21.0 million as of April 27, 2007, on certain of our deferred tax assets.

We are currently undergoing federal income tax audits in the United States and several foreign tax jurisdictions. The rights to some of our intellectual property (IP) are owned by certain of our foreign subsidiaries, and payments are made between foreign and U.S. tax jurisdictions relating to the use of this IP. Recently, some other companies have had their foreign IP arrangements challenged as part of an examination. Our management does not believe, based upon information currently known to us that the final resolution of any of our audits will have a material adverse effect upon our consolidated financial position and the results of operations and cash flows. However, if upon the conclusion of these audits the ultimate determination of our taxes owed in any of these tax jurisdictions is for an amount in excess of the tax provision we have recorded or reserved for, our overall effective tax rate may be adversely impacted in the period of adjustment.

On April 28, 2007, we adopted FIN No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (FIN No. 48). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. As a result of the implementation of FIN No. 48, we recognize the tax liability for uncertain income tax positions on the income tax return based on the two-step process prescribed in the interpretation. The first step is to determine whether it is more likely than not that each income tax position would be sustained upon audit. The second step is to estimate and measure the tax benefit as the amount that has a greater than 50% likelihood of being realized upon ultimate settlement with the tax authority. Estimating these amounts requires us to determine the probability of various possible outcomes. We evaluate these uncertain tax positions on a quarterly basis. This evaluation is based on the consideration of several factors, including changes in facts or circumstances, changes in applicable tax law, settlement of issues under audit, and new exposures. If we later determine that our exposure is lower or that the liability is not sufficient to cover our revised expectations, we adjust the liability and effect a related change in our tax provision during the period in which we make such determination.

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New Accounting Standards

See Note 15 of the Condensed Consolidated Financial Statements for a full description of new accounting pronouncements, including the respective expected dates of adoption and effects on results of operations and financial condition.

Results of Operations

The following table sets forth certain consolidated statements of income data as a percentage of total revenues for the periods indicated:

	Three Months Ended	
	July 27, 2007	July 28, 2006
Revenues:		
Product	67.2%	74.9%
Software entitlements and maintenance	15.7	12.0
Service	17.1	13.1
	100.0	100.0
Cost of Revenues:		
Cost of product	27.1	30.3
Cost of software entitlements and maintenance	0.3	0.4
Cost of service	12.1	9.3
Gross Profit	60.5	60.0
Operating Expenses:		
Sales and marketing	35.4	31.4
Research and development	15.5	14.3
General and administrative	6.0	5.2
Restructuring charges (recoveries)		
Total Operating Expenses	56.9	50.9
Income From Operations	3.6	9.1
Other Income (Expenses), Net:		
Interest income	2.5	2.7
Interest expense	(0.2)	(0.6)
Other income (expenses), net	0.1	0.1
Total Other Income, Net	2.4	2.2
Income Before Income Taxes	6.0	11.3
Provision for Income Taxes	1.0	2.5
Net Income	5.0%	8.8%

Discussion and Analysis of Results of Operations

Total Revenues Total revenues increased by 10.9% to $689.2 million for the first quarter of fiscal 2008, from $621.3 million for the same period in the prior year.

Product Revenues Product revenues decreased by 0.5% to $463.3 million for the first quarter of fiscal 2008, from $465.6 million for the same period in the prior year.

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Product revenues were impacted by the following factors:

Decreased revenues from our current product portfolio. Product revenue decreased $2.3 million in the first quarter of fiscal 2008 as compared to the same period a year ago, with a $35.0 million decrease due to price and configuration on existing products, offset by $32.7 million increase due to higher unit volume. Of the $32.7 million volume increase, $111.0 million revenue increase was due to new products, while offset by a $78.3 million decrease in overall revenue associated with lower shipment volumes on existing products. Price changes, volumes, and product model mix can have an effect on changes in product revenues; the impact on these forces is significantly affected by the configuration of systems shipped.

Lower-cost-per-petabyte storage is a significant component of our storage systems cost. As performance has improved on our devices, the related price we can charge per petabyte of storage has decreased as well.

Revenues from our older products declined by $177.5 million in the first quarter of fiscal 2008 compared to same quarter a year ago, primarily due to sales declines from older generation products. Revenue generated by FAS900 series systems and NearStore® R200 systems decreased by 94.6% and 99.2%, respectively. In addition, revenue also declined by $24.1 million in the first quarter of fiscal 2008 compared to the same period in the prior year due to products that we no longer ship, including our NetCache products.

Revenues of the FAS3000 and FAS6000 enterprise storage systems increased 15.3% and 198.1%, respectively, for the first quarter of fiscal 2008, compared to the same period in the prior year.

Increased sales through indirect channels in absolute dollars, including sales through our resellers, distributors, and OEM partners, represented 61.4% and 55.7% of total revenues for the first quarters of fiscal 2008 and fiscal 2007, respectively.

Our petabytes shipped increased 52.4% year over year to 110.9 petabytes due to increased penetration in primary and secondary storage, i.e., enterprise data centers, data protection, disaster recovery, archival, and compliance requirements. This increase in petabytes shipped was attributable to an increase in petabytes from 500-gigabyte ATA drives. ATA drives accounted for 56.8% of our total petabytes shipped in the first quarter of fiscal 2008 compared to 54.2% in the same quarter a year ago. Fibre Channel petabytes were up 42.4% year over year, to 42.7% of our total shipped.

Our systems are highly configurable to respond to customer requirements in the open systems storage markets that we serve. As a result, the wide variation in customized configuration can significantly impact revenue, cost of revenues, and gross margin performance. Price changes, volumes, and product model mix can have an effect on changes in product revenues; the impact on these forces is significantly affected by the configuration of systems shipped.

Software Entitlements and Maintenance Revenues Software entitlements and maintenance revenues increased by 44.2% to $107.9 million for the first quarter of fiscal 2008, from $74.8 million for the same period a year ago, due primarily to a larger installed base of customers who have purchased or renewed software entitlements and maintenance and the timing of software entitlements and maintenance revenue recognition. Software entitlements and maintenance revenues represented 15.7% and 12.0% of total revenues for the first quarter of fiscal 2008 and fiscal 2007, respectively.

Service Revenues Service revenues, which include hardware support, professional services, and educational services, increased by 45.9% to $118.0 million for the first quarter of fiscal 2008, from $80.8 million in the same period a year ago.

The increase in absolute dollars was due to the following factors:

Professional service revenue increased by 49.1% in the first quarter of fiscal 2008 compared to the same period a year ago, due to an increasing number of customers which typically have extremely complex IT environments and require professional services to integrate our solution into their environments.

Service maintenance revenue increased by 45.2% in the first quarter of fiscal 2008 compared to the same period a year ago due to a growing installed base, resulting in new customer support contracts and renewals in addition to the timing of service revenue recognition.

While it is an element of our strategy to expand and offer more comprehensive global enterprise support and service solutions, we cannot assure you that service revenue will grow at the current rate in the remainder of fiscal 2008 or beyond.

A large portion of our service revenues is deferred and, in most cases, recognized ratably over the service obligation periods, which are typically one to three years. Service revenues represented 17.1% and 13.1% of total revenues for the first quarters of fiscal 2008 and 2007, respectively.

International total revenues International total revenues (including U.S. exports) increased by 14.1% for the first quarter of fiscal 2008, as compared to the same periods in fiscal 2007. Total revenues from Europe were $218.5 million, or 31.7% of total revenues, for the first quarter of fiscal 2008, compared to $194.9 million, or 31.4% of total revenues, for the first quarter of fiscal 2007. Total revenues from Asia were $87.5 million, or 12.7% of total revenues for the first quarter of fiscal 2008, compared to $73.3 million, or 11.8% of total revenues for the same period a year ago. The increase in international sales was primarily driven by the same factors outlined under the Total Revenue discussion, as compared to the same periods in the prior fiscal year. We cannot assure you that we will be able to maintain or increase international revenues in the remainder of fiscal 2008 or beyond.

Product Gross Margin Product gross margin increased slightly to 59.7% for the first quarter of fiscal 2008, from 59.6% for the same period a year ago.

Product gross margin was impacted by:

- SFAS 123R stock compensation expenses recorded in fiscal 2007
- Sales price reductions due to competitive pricing pressure and selective pricing discounts
- Increased sales through certain indirect channels, which generate lower gross margins than our direct sales in certain geographic regions
- Higher disk content with an expanded storage capacity for the higher-end storage systems, as resale of disk drives generates lower gross margins

We expect that higher disk content associated with high-end and mid-range storage systems will negatively affect our gross margin in the future if not offset by increases in software revenue and new higher-margin products.

Stock-based compensation expense included in cost of product revenues was $0.9 million and $0.7 million for the first quarters of fiscal 2008 and 2007, respectively. Amortization of existing technology included in cost of product revenues was $5.3 million and $3.9 million for the first quarters of fiscal 2008 and 2007, respectively. Estimated future amortization of existing technology to cost of product revenues will be $15.8 million for the remainder of fiscal 2008, $20.4 million for fiscal year 2009, $15.9 million for fiscal year 2010, $6.3 million for fiscal year 2011, and none thereafter.

Software Entitlements and Maintenance Gross Margin Software entitlements and maintenance gross margins increased to 98.1% for the first quarter of fiscal 2008, from 96.9% for the same period a year ago.

Service Gross Margin Service gross margin increased to 29.5% for the first quarter of fiscal 2008 as compared to 28.3% for the same period in fiscal 2007. Cost of service revenue increased by 43.5% to $83.2 million for the first quarter of fiscal 2008 from $58.0 million for the same period a year ago. Stock-based compensation expense of

$2.7 million and $2.6 million was included in the cost of service revenue for the first quarters of fiscal 2008 and 2007, respectively.

The change in service gross margins year over year was primarily impacted by an increase in services revenue, improved productivity, and continued spending in our service infrastructure to support our customers. This spending included additional professional support engineers, increased support center activities, and global service partnership programs. Service gross margins will typically be impacted by factors such as timing of technical support service initiations and renewals and additional investments in our customer support infrastructure. In the remainder of fiscal 2008, we expect service margins to experience some variability over time as we continue to build out our service capability and capacity to support our growing customer base and new products.

Sales and Marketing Sales and marketing expenses consist primarily of salaries, commissions, advertising and promotional expenses, stock-based compensation expense, and certain customer service and support costs. Sales and marketing expenses increased 25.1% to $244.6 million for the first quarter of fiscal 2008, from $195.5 million for the same period a year ago. These expenses as a percentage of revenue increased to 35.4% for the first quarter of fiscal 2008 from 31.4% for the same period in the prior year due to our lower revenue growth in the first quarter of fiscal 2008. The increase in absolute dollars was attributed to increased commission expenses resulting from increased revenues, higher performance-based payroll expenses due to higher headcount, higher partner program expenses, and the continued worldwide investment in our sales and global service organizations associated with selling complete enterprise solutions.

Stock-based compensation expense included in sales and marketing expenses for the first quarters of fiscal 2008 and 2007 was $17.5 million and $18.7 million, respectively. Amortization of trademarks/tradenames and customer contracts/relationships included in sales and marketing expenses was $1.0 million and $0.6 million for the first quarters of fiscal 2008 and 2007, respectively. Based on identified intangibles related to our acquisitions recorded at July 27, 2007, estimated future amortization such as trademarks, and customer relationships included in sales and marketing expenses will be $2.9 million for the remainder of fiscal 2008, $3.8 million for fiscal 2009, $3.6 million for fiscal 2010, $2.7 million for fiscal 2011, $1.6 million for fiscal 2012, and $0.9 million thereafter.

We expect to continue to selectively add sales capacity in an effort to expand domestic and international markets, introduce new products, and establish and expand new distribution channels. We expect to increase our sales and marketing expenses commensurate with future revenue growth. We believe that our sales and marketing expenses will increase in absolute dollars for the remainder of fiscal 2008 due to increased headcount, sales- and marketing-related programs to support future revenue growth, and real estate lease payments, partially offset by cost control and reduction in discretionary spending efforts.

Research and Development Research and development expenses consist primarily of salaries and benefits, stock-based compensation, prototype expenses, nonrecurring engineering charges, fees paid to outside consultants, and amortization of capitalized patents.

Research and development expenses increased 20.2% to $106.6 million for the first quarter of fiscal 2008, from $88.7 million for the same period in fiscal 2007. These expenses as a percentage of revenue increased to 15.5% for the first quarter of fiscal 2008 from 14.3% for the same period in the prior year due to our lower revenue growth in the first quarter of fiscal 2008. The increase in absolute dollars was primarily a result of increased headcount-related salaries and incentive compensation, ongoing support of current and future product development and enhancement efforts. For the first quarters of fiscal 2008 and 2007, no software development costs were capitalized.

Stock-based compensation expense included in research and development expenses for the first quarters of fiscal 2008 and 2007 was $13.2 million and $13.9 million. Included in research and development expenses is capitalized patents amortization of $0.5 million and $0.5 million for the first quarters of fiscal 2008 and 2007, respectively. Based on capitalized patents recorded at July 27, 2007, estimated future capitalized patent amortization expenses for the remainder of fiscal 2008 will be $1.5 million, $0.5 million for fiscal year 2009, $0.2 million in fiscal 2010, and none thereafter.

We believe that our future performance will depend in large part on our ability to maintain and enhance our current product line, develop new products that achieve market acceptance, maintain technological competitiveness, and meet an expanding range of customer requirements. We expect to continuously support current and future product development and enhancement efforts and to incur prototyping expenses and nonrecurring engineering charges associated with the development of new products and technologies. We intend to continuously broaden our existing product offerings and to introduce new products that expand our solutions portfolio.

We believe that our research and development expenses will increase in absolute dollars for the remainder of fiscal 2008, primarily due to ongoing costs associated with the development of new products and technologies, headcount growth, real estate lease payments, and the operating impact of potential future acquisitions.

General and Administrative General and administrative expenses increased 27.9% to $41.5 million for the first quarter of fiscal 2008, from $32.4 million for the same period a year ago. These expenses as a percentage of

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revenue increased to 6.0% for the first quarter of fiscal 2008 from 5.2% for the same period in the prior year due to our lower revenue growth in the first quarter of fiscal 2008. This increase in absolute dollars was primarily due to higher payroll expenses, increased headcount, higher legal expenses on prior acquisition-related costs, and increased professional fees for general corporate matters.

We believe that our general and administrative expenses will increase in absolute dollars for the remainder of fiscal 2008 in order to support our existing infrastructure and real estate lease payments, partially offset by cost control and reduction in discretionary spending efforts. Stock-based compensation expense included in general and administrative expenses for the first quarters of fiscal 2008 and 2007 was $6.1 million and $7.1 million, respectively. Amortization of covenants not to compete included in general and administrative expenses was $0.2 million and $0.2 million for the first quarters of fiscal 2008 and 2007, respectively. Based on identified intangibles related to our acquisitions recorded at July 27, 2007, estimated future amortization of covenants not to compete relating to our acquisitions will be $0.1 million for fiscal year 2008, and none thereafter.

Operating Income Operating income as a percentage of revenue decreased to 3.6% for the first quarter of fiscal 2008 from 9.1% for the same period a year ago. Our operating expense levels are based in part on our expectations as to future revenue growth, and a significant percentage of our operating expenses are fixed and difficult to reduce within a short period of time. As a result, if revenue levels are below expectations or previously higher levels, our fixed expenses could adversely affect our operating income and cash flow until revenues increase or until such fixed expenses are reduced to a level commensurate with revenues . We cannot assure you that we will be able to maintain or increase revenues in the remainder of fiscal 2008 or beyond.

Restructuring Charges In fiscal 2002, as a result of continuing unfavorable economic conditions and a reduction in information technology (IT) spending rates, we implemented two restructuring plans, which included reductions in our workforce and consolidations of our facilities. As of July 27, 2007, we have no outstanding balance in our restructuring liability for the first restructuring. The second restructuring related to the closure of an engineering facility and consolidation of resources to the Sunnyvale headquarters. In fiscal 2006, we implemented a third restructuring plan related to the move of our global services center operations from Sunnyvale to our new flagship support center at our Research Triangle Park facility in North Carolina.

Our restructuring estimates are reviewed and revised periodically and may result in a substantial charge or reduction to restructuring expense should different conditions prevail than were anticipated in previous management estimates. Such estimates included various assumptions such as the time period over which the facilities will be vacant, expected sublease terms, and expected sublease rates. During the first quarter of fiscal 2008, we did not record any reduction in restructuring reserve resulting from change in estimate of our third restructuring plan.

Of the reserve balance at July 27, 2007, $0.5 million was included in other accrued liabilities, and the remaining $1.4 million was classified as long-term obligations. The balance of the reserve is expected to be paid by fiscal 2011.

The following analysis sets forth the significant components of the restructuring reserve at July 27, 2007 (in thousands):

	Facility	**Severance-Related Amounts**	**Total**
Reserve balance at April 28, 2006	$ 2,666	$ 338	$ 3,004
Recoveries		(74)	(74)

Cash payments and other	(582)	(264)	(846)
Reserve balance at April 27, 2007	$ 2,084		$ 2,084
Recoveries			
Cash payments and other	(153)		(153)
Reserve balance at July 27, 2007	$ 1,931	$	$ 1,931

Interest Income Interest income was $17.0 million and $16.7 million for the first quarters of fiscal 2008 and 2007, respectively. The increase in interest income was primarily driven by higher average interest rates on our

investment portfolio. We expect interest income to vary year over year as a result of our cash and invested balances being reinvested in a higher interest rate portfolio environment, partially offset by lower cash balances while we continue to fund working capital, future contractual obligations and capital expenditures.

Interest Expense Interest expense was $1.1 million and $3.9 million for the first quarters of fiscal 2008 and 2007, respectively. The decrease in fiscal 2008 was primarily due to lower debt balance at July 27, 2007, as compared to July 28, 2006.

Other Income Other income was $0.8 million for both the first quarters of fiscal 2008 and 2007. Other income included net exchange gains from foreign currency of $0.6 million and $0.8 million for the first quarters of fiscal 2008 and 2007, respectively. We believe that period-to-period changes in foreign exchange gains or losses will continue to be impacted by hedging costs associated with our forward and option activities and forecast variance.

Provision for Income Taxes For the first quarters of fiscal 2008 and 2007, we applied to pretax income an annual effective tax rate before discrete reporting items of 18.0% and 22.0%, respectively. The decrease to the annual effective tax rate year over year is primarily attributable to a relative decrease in the tax impact of nondeductible stock compensation under SFAS No. 123R, brought about in part by our decision to cease granting incentive stock options. Since we have replaced the granting of incentive stock options with the granting of additional nonqualified stock options, this gives rise to the recognition of more deferred tax assets as SFAS No. 123R expense occurs. After taking into account the tax effect of discrete items reported, the effective tax rates applied to the first quarters of fiscal 2008 and fiscal 2007 pretax income were 16.9% and 22.0%, respectively.

Our estimate of the effective tax rate is based on the application of existing tax laws to current projections of our annual consolidated income, including projections of the mix of income (loss) earned among our entities and tax jurisdictions in which they operate.

Liquidity and Capital Resources

The following sections discuss the effects of changes in our balance sheet and cash flow, contractual obligations and other commercial commitments, stock repurchase program, capital commitments, and other sources and uses of cash flow on our liquidity and capital resources.

Balance Sheet and Operating Cash Flows

As of July 27, 2007, as compared to April 27, 2007, our cash, cash equivalents, and short-term investments increased by $21.5 million to $1,330.3 million. We derive our liquidity and capital resources primarily from our cash flow from operations and from working capital. Working capital decreased by $36.4 million to $1,016.9 million as of July 27, 2007, compared to $1,053.3 million as of April 27, 2007.

During the first quarter of fiscal 2008, we generated cash flows from operating activities of $200.9 million, as compared with $164.6 million in the same period in fiscal 2007. We recorded net income of $34.3 million for the first quarter of fiscal 2008, as compared to $54.7 million for the same period a year ago. A summary of the significant changes in noncash adjustments affecting net income is as follows:

- Stock-based compensation expense was $40.4 million in the first quarter of fiscal 2008, compared to $43.0 million in the same period a year ago.

- Depreciation expense was $26.7 million and $18.7 million in the first quarters of fiscal 2008 and 2007, respectively. The increase was due to continued capital expansion to meet our business growth.

Amortization of intangibles was $6.4 million and $4.7 million in the first quarters of fiscal 2008 and 2007, respectively. The increase was attributed to the Topio acquisition.

An increase in net deferred tax assets of $17.8 million in the first quarter of fiscal 2008 compared to none in fiscal 2007, primarily due to an increase in book versus tax difference associated primarily with increases in deferred revenue and stock compensation tax benefits.

In addition to net income and noncash adjustments for the first quarter of fiscal 2008, the primary factors that impacted the period-to-period change in cash flows relating to operating activities included the following:

Decrease in accounts receivable of $188.1 million in the first quarter of fiscal 2008 was due to lower revenue volume. A decrease of $69.9 million in accounts receivable in the first quarter of fiscal 2007 was due to more linear shipments.

An increase in deferred revenues of $46.5 million and $61.9 million in the first quarters of fiscal 2008 and 2007, respectively, was due to the timing of recognition of software entitlements and maintenance and service revenue as well as renewals of existing maintenance agreements in the first quarters of fiscal 2008 and fiscal 2007.

Increase in income taxes payable of $18.4 million in the first quarter of fiscal 2008 was attributed to the tax provision of $7.0 million, $17.8 million book tax differences and stock compensation tax benefits, offset by $6.4 million income tax payments. Income tax payable decreased $6.9 million in the first quarter of fiscal 2007 due to tax payments of $22.5 million, which included an $18.7 million federal income tax payment made for the fiscal year 2006 foreign dividend repatriation, partially offset by the first quarter tax provision of $15.4 million.

The above factors were partially offset by the effects of:

Accrued compensation and related benefits decreased by $69.9 million and $39.0 million in the first quarters of fiscal 2008 and 2007, respectively. The changes for both periods were due to payout of commission and performance-based payroll expenses accrued in the last quarter of each fiscal year and paid in the first quarter of each subsequent fiscal year.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, shipment linearity, accounts receivable collections, inventory management, and the timing of tax and other payments.

Cash Flows from Investing Activities

Capital expenditures for the first quarter of fiscal 2008 were $33.6 million as compared to $23.1 million for the same period a year ago. We received net proceeds of $118.1 million and $32.0 million in the first quarters of fiscal 2008 and 2007, respectively, for net purchases/redemptions of short-term investments. We redeemed $14.9 million and $16.3 million of restricted investment and its interest income pledged with JP Morgan Chase to repay the term loan with JP Morgan Chase in the first quarters of fiscal 2008 and 2007, respectively (See Note 5.) Investing activities in the first quarters of fiscal 2008 and fiscal 2007 also included new investments in privately held companies of $4.0 million and $1.2 million, respectively.

Cash Flows from Financing Activities

We used $160.4 million and $207.5 million in the first quarters of fiscal 2008 and 2007, respectively, for net financing activities, which included repayment of debt, sales of common stock related to employee stock transactions, and common stock repurchases. We made a repayment of $16.0 million and $27.9 million for our debt during the first quarters of fiscal 2008 and 2007, respectively. We repurchased 6.5 million and 6.6 million shares of common stock at a total of $200.0 million and $220.0 million during the first quarters of fiscal 2008 and 2007, respectively. Other financing activities provided $50.0 million and $36.8 million in the first quarters of fiscal 2008 and 2007, respectively,

from sales of common stock related to employee stock option exercises and employee stock purchases. Tax benefits, related to tax deductions in excess of the stock-based compensation expense recognized, of $8.3 million and $4.5 million were presented as financing cash flows for the first quarters of fiscal 2008 and 2007, respectively, in accordance with SFAS No. 123R. During the first quarters of fiscal 2008 and 2007, we withheld shares with an aggregate value of $2.7 million and $1.0 million, respectively, in connection with the exercising of certain employees restricted stock for purposes of satisfying those employees federal, state, and local withholding tax obligations. The increase in the amounts withheld year over year was due to the release of restricted stock units assumed in connection with the Decru acquisition.

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The change in cash flow from financing was primarily due to the effects of higher common stock repurchases partially offset by proceeds from the issuance of common stock under employee equity programs compared to the same period in the prior year. Net proceeds from the issuance of common stock related to employee participation in employee stock programs have historically been a significant component of our liquidity. The extent to which our employees participate in these programs generally increases or decreases based upon changes in the market price of our common stock. As a result, our cash flow resulting from the issuance of common stock related to employee participation in employee stock programs will vary.

Other Factors Affecting Liquidity and Capital Resources

For the first quarters of fiscal 2008 and 2007, the income tax benefit associated with dispositions of employee stock transactions was $20.7 million and $30.0 million, respectively. If stock option exercise patterns change, we may receive less cash from stock option exercises and may not receive the same level of tax benefits in the future, which could cause our cash payments for income taxes to increase.

Stock Repurchase Program

At July 27, 2007, $199.9 million remained available for future repurchases under plans approved as of that date. The stock repurchase program may be suspended or discontinued at any time.

On August 14, 2007, the Board of Directors approved a new stock repurchase program in which up to $1.0 billion worth of additional common stock may be purchased in addition to $199.9 million remaining from all prior authorizations. On August 20, 2007, we repurchased $225.0 million in common stock pursuant to our existing and new stock repurchases programs.

Debt

In March 2006, we received proceeds from a term loan totaling $300.0 million to finance a dividend under the Jobs Act. (See Note 5 of the Condensed Consolidated Financial Statements.) Loan repayments of $69.2 million are due in the remainder of fiscal 2008. This debt was collateralized by restricted investments totaling $101.5 million as of July 27, 2007. In accordance with the payment terms of the loan agreement, interest payments will be approximately $1.6 million in the remainder of fiscal 2008. As of July 27, 2007, we were in compliance with the liquidity and leverage ratio as required by the Loan Agreement with the lenders.

Contractual Cash Obligations and Other Commercial Commitments

The following summarizes our contractual cash obligations and commercial commitments at July 27, 2007, and the effect such obligations are expected to have on our liquidity and cash flow in future periods, (in thousands):

Contractual Obligations:	**2008**	**2009**	**2010**	**2011**	**2012**	**Thereafter**	**Total**
				(In thousands)			
Office operating lease payments(1)	$ 18,226	$ 23,948	$ 24,391	$ 17,970	$ 12,568	$ 29,680	$ 126,783
Real estate lease payments(2)	925	7,579	9,981	9,981	9,981	162,110	200,557
Equipment operating lease payments(3)	8,746	10,065	4,737	187			23,735

Venture capital funding commitments(4)	212	270	257	245	52,930	156,566	209,496
Gain on sale or write down of assets, net	—	13,426	13,426				
Net (loss) income	$(3,247)	$ 44,646	$ 41,399				
Company's equity in net income	$620	$ 23,373	$ 23,993				
Three Months Ended September 30, 2016							
Revenues:							
Minimum rents	$33,332	$ 121,109	$ 154,441				
Percentage rents	1,117	4,228	5,345				
Tenant recoveries	11,933	48,540	60,473				
Other	987	11,697	12,684				
Total revenues	47,369	185,574	232,943				
Expenses:							
Shopping center and operating expenses	9,897	61,335	71,232				
Interest expense	16,688	32,126	48,814				
Depreciation and amortization	27,091	70,030	97,121				
Total operating expenses	53,676	163,491	217,167				
Loss on sale or write down of assets, net	—	(343)	(343)				
Net (loss) income	$(6,307)	$ 21,740	$ 15,433				
Company's equity in net (loss) income	$(871)	$ 12,132	$ 11,261				

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THE MACERICH COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, except per share amounts)
(Unaudited)
4. Investments in Unconsolidated Joint Ventures: (Continued)

	PPR Portfolio	Other Joint Ventures	Total
Nine Months Ended September 30, 2017			
Revenues:			
Minimum rents	$100,633	$373,931	$474,564
Percentage rents	1,854	7,817	9,671
Tenant recoveries	34,827	141,875	176,702
Other	4,141	36,857	40,998
Total revenues	141,455	560,480	701,935
Expenses:			
Shopping center and operating expenses	30,062	181,475	211,537
Interest expense	50,291	98,469	148,760
Depreciation and amortization	76,527	187,927	264,454
Total operating expenses	156,880	467,871	624,751
(Loss) gain on sale or write down of assets, net	(35)	18,005	17,970
Net (loss) income	$(15,460)	$110,614	$95,154
Company's equity in net (loss) income	$(1,376)	$58,148	$56,772
Nine Months Ended September 30, 2016			
Revenues:			
Minimum rents	$95,389	$347,146	$442,535
Percentage rents	2,219	8,605	10,824
Tenant recoveries	35,828	138,635	174,463
Other	4,514	34,801	39,315
Total revenues	137,950	529,187	667,137
Expenses:			
Shopping center and operating expenses	28,997	173,563	202,560
Interest expense	47,957	91,130	139,087
Depreciation and amortization	81,971	187,327	269,298
Total operating expenses	158,925	452,020	610,945
Loss on sale or write down of assets, net	—	(343)	(343)
Net (loss) income	$(20,975)	$76,824	$55,849
Company's equity in net (loss) income	$(3,845)	$41,382	$37,537

Significant accounting policies used by the unconsolidated joint ventures are similar to those used by the Company.

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5. Property, net:
Property, net consists of the following:

	September 30, 2017	December 31, 2016
Land	$ 1,578,877	$ 1,607,590
Buildings and improvements	6,412,728	6,511,741
Tenant improvements	613,854	622,878
Equipment and furnishings	184,379	177,036
Construction in progress	342,539	289,966
	9,132,377	9,209,211
Less accumulated depreciation	(1,967,728)	(1,851,901)
	$ 7,164,649	$ 7,357,310

Depreciation expense was $69,343 and $68,792 for the three months ended September 30, 2017 and 2016, respectively, and $207,663 and $206,870 for the nine months ended September 30, 2017 and 2016, respectively.
The (loss) gain on sale or write down of assets, net was $(11,854) and $(19,321) for the three months ended September 30, 2017 and 2016, respectively, and $37,234 and $426,050 for the nine months ended September 30, 2017 and 2016, respectively.
The (loss) gain on sale or write down of assets, net for the nine months ended September 30, 2017 includes a gain of $59,698 on the sale of Cascade Mall and Northgate Mall (See Note 14—Dispositions) offset in part by a loss of $10,138 on the write down of an investment in non-real estate assets.
The (loss) gain on sale or write down of assets, net for the nine months ended September 30, 2016 includes a gain of $101,629 on the sale of a 40% ownership interest in Arrowhead Towne Center (See Note 4—Investments in Unconsolidated Joint Ventures), a gain of $340,734 on the sale of a 49% ownership interest in the MAC Heitman Portfolio (See Note 4—Investments in Unconsolidated Joint Ventures), a gain of $24,894 on the sale of Capitola Mall (See Note 14—Dispositions), a loss of $3,066 on the sale of a former Mervyn's store (See Note 14—Dispositions) and a loss of $12,180 on an adjustment to contingent consideration (See Note 13—Acquisitions).
The (loss) gain on sale or write down of assets, net also includes impairment losses of $12,036 on Southridge Center for the three and nine months ended September 30, 2017, $23,335 on Promenade at Casa Grande for the three and nine months ended September 30, 2016 and $7,188 on The Marketplace at Flagstaff for the nine months ended September 30, 2016. The impairment losses are due to the reduction of the estimated holding period of the properties.
The following table summarizes certain of the Company's assets that were measured on a nonrecurring basis as a result of impairment charges recorded for the three and nine months ended September 30, 2017 and 2016 as described above:

	Total Fair Value Measurement	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Unobservable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2017	$ 11,500	$ —	$ 11,500	$ —
2016	$ 66,000	$ —	$ —	$ 66,000

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(Dollars in thousands, except per share amounts)
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5. Property, net: (Continued)

The fair value relating to impairment assessments were based upon a discounted cash flow model that includes all cash inflows and outflows over a specific holding period, or the negotiated sales price, if applicable. Projected cash flows are comprised of contractual rental revenues and forecasted rental revenues and expenses based upon market conditions and expectations for growth. Terminal capitalization rates and discount rates utilized in these models are based on a reasonable range of current market rates for each property analyzed. Based upon these inputs, the Company determined that its valuations of properties using a discounted cash flow model are classified within Level 3 of the fair value hierarchy.
The following table sets forth quantitative information about the unobservable inputs of the Company’s Level 3 real estate recorded as of September 30, 2016:

Terminal capitalization rate	7.0% - 8.0%
Discount rate	8.0% - 9.5%
Market rents per square foot	$5.75 - $20.00

6. Tenant and Other Receivables, net:
Included in tenant and other receivables, net is an allowance for doubtful accounts of $2,559 and $1,991 at September 30, 2017 and December 31, 2016, respectively. Also included in tenant and other receivables, net are accrued percentage rents of $1,866 and $9,509 at September 30, 2017 and December 31, 2016, respectively, and a deferred rent receivable due to straight-line rent adjustments of $62,182 and $56,761 at September 30, 2017 and December 31, 2016, respectively.
On March 17, 2014, in connection with the sale of Lake Square Mall, the Company issued a note receivable for $6,500 that bore interest at an effective rate of 6.5%, which was collateralized by a trust deed on Lake Square Mall and that was to mature on March 17, 2018. At September 30, 2017 and December 31, 2016, the note had a balance of $6,245 and $6,284, respectively. On October 20, 2017, the note was repaid in full. The Company used the proceeds from the repayment for general corporate purposes.

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7. Deferred Charges and Other Assets, net:

Deferred charges and other assets, net consist of the following:

	September 30, 2017	December 31, 2016
Leasing	$ 232,443	$ 239,983
Intangible assets:		
In-place lease values	112,994	140,437
Leasing commissions and legal costs	27,621	32,384
Above-market leases	171,156	181,851
Deferred tax assets	44,964	38,301
Deferred compensation plan assets	49,430	42,711
Other assets	59,358	72,206
	697,966	747,873
Less accumulated amortization(1)	(258,471)	(269,815)
	$ 439,495	$ 478,058

(1) Accumulated amortization includes $75,818 and $88,785 relating to in-place lease values, leasing commissions and legal costs at September 30, 2017 and December 31, 2016, respectively. Amortization expense of in-place lease values, leasing commissions and legal costs was $4,206 and $8,983 for the three months ended September 30, 2017 and 2016, respectively, and $15,755 and $26,033 for the nine months ended September 30, 2017 and 2016, respectively.

The allocated values of above-market leases and below-market leases consist of the following:

	September 30, 2017	December 31, 2016
Above-Market Leases		
Original allocated value	$ 171,156	$ 181,851
Less accumulated amortization	(61,000)	(57,505)
	$ 110,156	$ 124,346
Below-Market Leases(1)		
Original allocated value	$ 128,750	$ 144,713
Less accumulated amortization	(57,314)	(58,400)
	$ 71,436	$ 86,313

(1) Below-market leases are included in other accrued liabilities.

THE MACERICH COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars in thousands, except per share amounts)

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8. Mortgage Notes Payable:

Mortgage notes payable at September 30, 2017 and December 31, 2016 consist of the following:

	Carrying Amount of Mortgage Notes(1)						
	September 30, 2017		December 31, 2016				
Property Pledged as Collateral	Related Party	Other	Related Party	Other	Effective Interest Rate(2)	Monthly Debt Service(3)	Maturity Date(4)
Chandler Fashion Center(5)	$—	$199,885	$—	$199,833	3.77 %	$ 625	2019
Danbury Fair Mall	105,448	105,448	107,929	107,928	5.53 %	1,538	2020
Fashion Outlets of Chicago(6)	—	199,218	—	198,966	2.90 %	457	2020
Fashion Outlets of Niagara Falls USA	—	113,534	—	115,762	4.89 %	727	2020
Freehold Raceway Mall(5)(7)	—	217,379	—	220,643	4.20 %	1,132	2018
Fresno Fashion Fair	—	323,208	—	323,062	3.67 %	971	2026
Green Acres Commons(8)	—	107,446	—	—	3.96 %	312	2021
Green Acres Mall	—	293,004	—	297,798	3.61 %	1,447	2021
Kings Plaza Shopping Center	—	449,709	—	456,958	3.67 %	2,229	2019
Northgate Mall(9)	—	—	—	63,434	—	—	—
Oaks, The	—	197,875	—	201,235	4.14 %	1,064	2022
Pacific View	—	125,136	—	127,311	4.08 %	668	2022
Queens Center	—	600,000	—	600,000	3.49 %	1,744	2025
Santa Monica Place(10)	—	215,508	—	219,564	2.99 %	1,004	2018
SanTan Village Regional Center	—	125,470	—	127,724	3.14 %	589	2019
Stonewood Center(11)	—	94,994	—	99,520	1.80 %	640	2017
Towne Mall	—	21,266	—	21,570	4.48 %	117	2022
Tucson La Encantada	67,362	—	68,513	—	4.23 %	368	2022
Victor Valley, Mall of	—	114,602	—	114,559	4.00 %	380	2024
Vintage Faire Mall	—	265,195	—	269,228	3.55 %	1,256	2026
Westside Pavilion	—	141,987	—	143,881	4.49 %	783	2022
	$172,810	$3,910,864	$176,442	$3,908,976			

(1) The mortgage notes payable balances include the unamortized debt premiums (discounts). Debt premiums (discounts) represent the excess (deficiency) of the fair value of debt over (under) the principal value of debt assumed in various acquisitions and are amortized into interest expense over the remaining term of the related debt in a manner that approximates the effective interest method. Debt premiums (discounts) consist of the following:

Property Pledged as Collateral	September 30, 2017	December 31, 2016
Fashion Outlets of Niagara Falls USA	$ 2,862	$ 3,558
Stonewood Center	246	2,349
	$ 3,108	$ 5,907

The mortgage notes payable balances also include unamortized deferred finance costs that are amortized into interest expense over the remaining term of the related debt in a manner that approximates the effective interest method. Unamortized deferred finance costs were $12,810 and $12,716 at September 30, 2017 and December 31, 2016, respectively.

(2) The interest rate disclosed represents the effective interest rate, including the debt premiums (discounts) and deferred finance costs.

(3) The monthly debt service represents the payment of principal and interest.

(4) The maturity date assumes that all extension options are fully exercised and that the Company does not opt to refinance the debt prior to these dates. These extension options are at the Company's discretion, subject to certain conditions, which the Company believes will be met.

(5) A 49.9% interest in the loan has been assumed by a third party in connection with a co-venture arrangement (See Note 10—Co-Venture Arrangement).

(6) The loan bears interest at LIBOR plus 1.50% and matures on March 31, 2020. At September 30, 2017 and December 31, 2016, the total interest rate was 2.90% and 2.43%, respectively.

(7) On October 19, 2017, the joint venture replaced the existing loan on the property with a new $400,000 loan that bears interest at 3.90% and matures on November 1, 2029 (See Note 19—Subsequent Events).

(8) On September 29, 2017, the Company placed a new $110,000 loan on the property that bears interest at LIBOR plus 2.15% and matures on March 29, 2021. The loan can be expanded, depending on certain conditions, up to $130,000. At September 30, 2017, the total interest rate was 3.96%.

(9) On January 18, 2017, the loan was paid off in connection with the sale of the underlying property (See Note 14—Dispositions).

(10) On October 13, 2017, the Company entered into a loan commitment with a lender to replace the existing loan on the property with a new $300,000 five-year floating rate loan. The new loan is expected to close in the fourth quarter of 2017. The Company expects to use the excess proceeds to pay down its line of credit (See Note 19—Subsequent Events).

(11) On November 1, 2017, the Company paid off the loan on the property (See Note 19—Subsequent Events).

Most of the mortgage loan agreements contain a prepayment penalty provision for the early extinguishment of the debt.

The Company's mortgage notes payable are secured by the properties on which they are placed and are non-recourse to the Company.

The Company expects that all loan maturities during the next twelve months will be refinanced, restructured, extended and/or paid-off from the Company's line of credit or with cash on hand.

Total interest expense capitalized was $3,428 and $2,707 for the three months ended September 30, 2017 and 2016, respectively, and $9,405 and $7,572 for the nine months ended September 30, 2017 and 2016, respectively.

Related party mortgage notes payable are amounts due to an affiliate of NML. See Note 16—Related Party Transactions for interest expense associated with loans from NML.

The estimated fair value (Level 2 measurement) of mortgage notes payable at September 30, 2017 and December 31, 2016 was $4,112,364 and $4,126,819, respectively, based on current interest rates for comparable loans. Fair value was determined using a present value model and an interest rate that included a credit value adjustment based on the estimated value of the property that serves as collateral for the underlying debt.

9. Bank and Other Notes Payable:

Bank and other notes payable consist of the following:

Line of Credit:

The Company has a $1,500,000 revolving line of credit that bears interest at LIBOR plus a spread of 1.30% to 1.90%, depending on the Company's overall leverage level, and matures on July 6, 2020 with a one-year extension option. The line of credit can be expanded, depending on certain conditions, up to a total facility of $2,000,000.

Based on the Company's leverage level as of September 30, 2017, the borrowing rate on the facility was LIBOR plus 1.45%. As of September 30, 2017 and December 31, 2016, borrowings under the line of credit, were $970,000 and $885,000, respectively, less unamortized deferred finance costs of $8,176 and $10,039, respectively, at a total interest rate of 3.01% and 2.40%, respectively. The estimated fair value (Level 2 measurement) of the line of credit at September 30, 2017 and December 31, 2016 was $960,233 and $865,921, respectively, based on a present value model using a credit interest rate spread offered to the Company for comparable debt.

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9. Bank and Other Notes Payable: (Continued)

Prasada Note:
On March 29, 2013, the Company issued a $13,330 note payable that bears interest at 5.25% and matures on May 30, 2021. The note payable is collateralized by a portion of a development reimbursement agreement with the City of Surprise, Arizona. At September 30, 2017 and December 31, 2016, the note had a balance of $4,933 and $5,521, respectively. The estimated fair value (Level 2 measurement) of the note at September 30, 2017 and December 31, 2016 was $5,067 and $5,786, respectively, based on current interest rates for comparable notes. Fair value was determined using a present value model and an interest rate that included a credit value adjustment based on the estimated value of the collateral for the underlying debt.
As of September 30, 2017 and December 31, 2016, the Company was in compliance with all applicable financial loan covenants.
10. Co-Venture Arrangement:
On September 30, 2009, the Company formed a joint venture, whereby a third party acquired a 49.9% interest in Freehold Raceway Mall, a 1,671,000 square foot regional shopping center in Freehold, New Jersey, and Chandler Fashion Center, a 1,318,000 square foot regional shopping center in Chandler, Arizona.
As a result of the Company having certain rights under the agreement to repurchase the assets after the seventh year of the venture formation, the transaction did not qualify for sale treatment. The Company, however, is not obligated to repurchase the assets. The transaction has been accounted for as a profit-sharing arrangement, and accordingly the assets, liabilities and operations of the properties remain on the books of the Company and a co-venture obligation was established for the amount of $168,154, representing the net cash proceeds received from the third party. The co-venture obligation is increased for the allocation of income to the co-venture partner and decreased for distributions to the co-venture partner. The co-venture obligation was $59,118 and $58,973 at September 30, 2017 and December 31, 2016, respectively.
11. Noncontrolling Interests:
The Company allocates net income of the Operating Partnership based on the weighted average ownership interest during the period. The net income of the Operating Partnership that is not attributable to the Company is reflected in the consolidated statements of operations as noncontrolling interests. The Company adjusts the noncontrolling interests in the Operating Partnership at the end of each period to reflect its ownership interest in the Company. The Company had a 93% ownership interest in the Operating Partnership as of September 30, 2017 and December 31, 2016. The remaining 7% limited partnership interest as of September 30, 2017 and December 31, 2016 was owned by certain of the Company's executive officers and directors, certain of their affiliates and other third party investors in the form of OP Units. The OP Units may be redeemed for shares of stock or cash, at the Company's option. The redemption value for each OP Unit as of any balance sheet date is the amount equal to the average of the closing price per share of the Company's common stock, par value $0.01 per share, as reported on the New York Stock Exchange for the 10 trading days ending on the respective balance sheet date. Accordingly, as of September 30, 2017 and December 31, 2016, the aggregate redemption value of the then-outstanding OP Units not owned by the Company was $555,597 and $733,141, respectively.
The Company issued common and preferred units of MACWH, LP in April 2005 in connection with the acquisition of the Wilmorite portfolio. The common and preferred units of MACWH, LP are redeemable at the election of the holder. The Company may redeem them for cash or shares of the Company's stock at the Company's option and they are classified as permanent equity.
Included in permanent equity are outside ownership interests in various consolidated joint ventures. The joint ventures do not have rights that require the Company to redeem the ownership interests in either cash or stock.

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12. Stockholders' Equity:

2015 Stock Buyback Program:

On September 30, 2015, the Company's Board of Directors authorized the repurchase of up to $1,200,000 of the Company's outstanding common shares over the period ending September 30, 2017, as market conditions warranted.
On November 12, 2015, the Company entered into an accelerated share repurchase program ("ASR") to repurchase $400,000 of the Company's common stock. In accordance with the ASR, the Company made a prepayment of $400,000 and received an initial share delivery of 4,140,788 shares. On January 19, 2016, the ASR was completed and the Company received delivery of an additional 970,609 shares. The average price of the 5,111,397 shares repurchased under the ASR was $78.26 per share. The ASR was funded from proceeds in connection with the financing and sale of a 40% ownership interest in the PPR Portfolio.
On February 17, 2016, the Company entered into an ASR to repurchase an additional $400,000 of the Company's common stock. In accordance with the ASR, the Company made a prepayment of $400,000 and received an initial share delivery of 4,222,193 shares. On April 19, 2016, the ASR was completed and the Company received delivery of an additional 861,235 shares. The average price of the 5,083,428 shares repurchased under the ASR was $78.69 per share. The ASR was funded from borrowings under the Company's line of credit, which had been paid down from the proceeds from the financings and sale of ownership interests in Arrowhead Towne Center and the MAC Heitman Portfolio (See Note 4—Investments in Unconsolidated Joint Ventures).
On May 9, 2016, the Company entered into an ASR to repurchase the remaining $400,000 of the Company's common stock authorized for repurchase. In accordance with the ASR, the Company made a prepayment of $400,000 and received an initial share delivery of 3,964,812 shares. On July 11, 2016, the ASR was completed and the Company received delivery of an additional 1,104,162 shares. The average price of the 5,068,974 shares repurchased under the ASR was $78.91 per share. The ASR was funded from borrowings under the Company's line of credit, which had been paid down from the proceeds from the financings and sale of ownership interests in Arrowhead Towne Center and the MAC Heitman Portfolio (See Note 4—Investments in Unconsolidated Joint Ventures).

2017 Stock Buyback Program:

On February 12, 2017, the Company's Board of Directors authorized the repurchase of up to $500,000 of its outstanding common shares as market conditions and the Company’s liquidity warrant. Repurchases may be made through open market purchases, privately negotiated transactions, structured or derivative transactions, including ASR transactions, or other methods of acquiring shares and pursuant to Rule 10b5-1 of the Securities Act of 1934, from time to time as permitted by securities laws and other legal requirements.
During the period from February 12, 2017 to September 30, 2017, the Company repurchased a total of 3,627,390 of its common shares for $221,428, representing an average price of $61.01 per share. The Company funded the repurchases from the net proceeds of the sale of Cascade Mall and Northgate Mall (See Note 14—Dispositions), its share of the proceeds from the sale of office buildings at Fashion District Philadelphia and Country Club Plaza (See Note 4—Investments in Unconsolidated Joint Ventures) and from borrowings under its line of credit.

Special Dividends:

On October 30, 2015, the Company declared two special dividends/distributions ("Special Dividend"), each of $2.00 per share of common stock and per OP Unit. The first Special Dividend was paid on December 8, 2015 to common stockholders and OP Unit holders of record on November 12, 2015. The second Special Dividend was paid on January 6, 2016 to common stockholders and OP Unit holders of record on November 12, 2015. The Special Dividends were funded from proceeds in connection with the financing and sale of ownership interests in the PPR Portfolio and Arrowhead Towne Center (See Note 4—Investments in Unconsolidated Joint Ventures).

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12. Stockholders' Equity: (Continued)

At-The-Market Stock Offering Program ("ATM Program"):

On August 20, 2014, the Company entered into an equity distribution agreement with a number of sales agents (the "ATM Program") to issue and sell, from time to time, shares of common stock, par value $0.01 per share, having an aggregate offering price of up to $500,000 (the “ATM Shares”). Sales of the ATM Shares could have been made in privately negotiated transactions and/or any other method permitted by law, including sales deemed to be an “at the market” offering, which included sales made directly on the New York Stock Exchange or sales made to or through a market maker other than on an exchange. The Company agreed to pay each sales agent a commission that was not to exceed, but could have been lower than, 2% of the gross proceeds of the ATM Shares sold through such sales agent under the distribution agreement. The ATM program expired by its term in August 2017. No shares were sold under the program.

13. Acquisitions:

Fashion Outlets of Chicago:

On October 31, 2014, the Company purchased the outside ownership interest in its consolidated joint venture in Fashion Outlets of Chicago for $69,987. The purchase price was funded by a cash payment of $55,867 and the settlement of the balance on notes receivables of $14,120. The purchase agreement included contingent consideration based on the financial performance of Fashion Outlets of Chicago at an agreed upon date in 2016. On August 19, 2016, the Company paid $23,800 in full settlement of the contingent consideration obligation.

14. Dispositions:

The following are recent dispositions of properties:

On April 13, 2016, the Company sold Capitola Mall, a 586,000 square foot regional shopping center in Capitola, California, for $93,000, resulting in a gain on the sale of assets of $24,894. The Company used the proceeds from the sale to pay down its line of credit and for general corporate purposes.

On May 31, 2016, the Company sold a former Mervyn's store in Yuma, Arizona, for $3,200, resulting in a loss on the sale of assets of $3,066. The Company used the proceeds from the sale to pay down its line of credit and for general corporate purposes.

On July 15, 2016, the Company conveyed Flagstaff Mall, a 347,000 square foot regional shopping center in Flagstaff, Arizona, to the mortgage lender by a deed-in-lieu of foreclosure and was discharged from the mortgage note payable. The loan was non-recourse to the Company. As a result, the Company recognized a gain on the extinguishment of debt of $5,284.

On January 18, 2017, the Company sold Cascade Mall, a 589,000 square foot regional shopping center in Burlington, Washington; and Northgate Mall, a 750,000 square foot regional shopping center in San Rafael, California, in a combined transaction for $170,000, resulting in a gain on the sale of assets of $59,698. The proceeds were used to pay off the mortgage note payable on Northgate Mall and to repurchase shares of the Company's common stock under the 2017 Stock Buyback Program (See Note 12—Stockholders' Equity).

15. Commitments and Contingencies:

The Company has certain properties that are subject to non-cancelable operating ground leases. The leases expire at various times through 2098, subject in some cases to options to extend the terms of the lease. Certain leases provide for contingent rent payments based on a percentage of base rental income, as defined in the lease. Ground lease rent expense was $2,589 and $2,395 for the three months ended September 30, 2017 and 2016, respectively, and $7,757 and $7,312 for the nine months ended September 30, 2017 and 2016, respectively. No contingent rent was incurred during the three and nine months ended September 30, 2017 or 2016.

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15. Commitments and Contingencies: (Continued)

As of September 30, 2017, the Company was contingently liable for $60,927 in letters of credit guaranteeing performance by the Company of certain obligations relating to the Centers. The Company does not believe that these letters of credit will result in a liability to the Company.
The Company has entered into a number of construction agreements related to its redevelopment and development activities. Obligations under these agreements are contingent upon the completion of the services within the guidelines specified in the agreements. At September 30, 2017, the Company had $62,609 in outstanding obligations which it believes will be settled in the next twelve months.
16. Related Party Transactions:
Certain unconsolidated joint ventures have engaged the Management Companies to manage the operations of the Centers. Under these arrangements, the Management Companies are reimbursed for compensation paid to on-site employees, leasing agents and project managers at the Centers, as well as insurance costs and other administrative expenses.
The following are fees charged to unconsolidated joint ventures:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
Management fees	$4,749	$4,271	$13,914	$13,240
Development and leasing fees	3,385	2,952	11,376	10,149
	$8,134	$7,223	$25,290	$23,389

Certain mortgage notes on the properties are held by NML (See Note 8—Mortgage Notes Payable). Interest expense in connection with these notes was $2,175 and $2,224 for the three months ended September 30, 2017 and 2016, respectively, and $6,567 and $6,752 for the nine months ended September 30, 2017 and 2016, respectively. Included in accounts payable and accrued expenses is interest payable on these notes of $721 and $736 at September 30, 2017 and December 31, 2016, respectively.
Due from (to) affiliates includes unreimbursed and/or prepaid costs and fees from unconsolidated joint ventures due to (from) the Management Companies. As of September 30, 2017 and December 31, 2016, the amounts due from (to) the unconsolidated joint ventures was $4,905 and $(6,809), respectively.
In addition, due from affiliates at September 30, 2017 and December 31, 2016 included a note receivable from RED/303 LLC ("RED") that bears interest at 5.25% and matures on May 30, 2021. Interest income earned on this note was $66 and $81 for the three months ended September 30, 2017 and 2016, respectively, and $204 and $294 for the nine months ended September 30, 2017 and 2016, respectively. The balance on this note was $4,998 and $5,593 at September 30, 2017 and December 31, 2016, respectively. RED is considered a related party because it is a partner in a joint venture development project. The note is collateralized by RED's membership interest in the development project.
Also included in due from affiliates is a note receivable from Lennar Corporation that bears interest at LIBOR plus 2% and matures upon the completion of certain milestones in connection with the development of Fashion Outlets of San Francisco. Interest income earned on this note was $621 and $583 for the three months ended September 30, 2017 and 2016, respectively, and $1,839 and $1,629 for the nine months ended September 30, 2017 and 2016, respectively. The balance on this note was $71,281 and $69,443 at September 30, 2017 and December 31, 2016, respectively. Lennar Corporation is considered a related party because it is a joint venture partner in Fashion Outlets of San Francisco.

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17. Share and Unit-Based Plans:

Under the Long-Term Incentive Plan ("LTIP"), each award recipient is issued a form of units ("LTIP Units") in the Operating Partnership. Upon the occurrence of specified events and subject to the satisfaction of applicable vesting conditions, LTIP Units (after conversion into OP Units) are ultimately redeemable for common stock of the Company, or cash at the Company's option, on a one-unit for one-share basis. LTIP Units receive cash dividends based on the dividend amount paid on the common stock of the Company. The LTIP may include both market-indexed awards and service-based awards.

The market-indexed LTIP Units vest over the service period of the award based on the percentile ranking of the Company in terms of total return to the stockholders (the "Total Return") per common stock share relative to the Total Return of a group of peer REITs, as measured at the end of the measurement period.

On January 1, 2017, the Company granted 66,079 LTIP Units with a grant date fair value of $70.84 per LTIP Unit that will vest in equal annual installments over a service period ending December 31, 2019. Concurrently, the Company granted 297,849 market-indexed LTIP Units ("2017 LTIP Units") at a grant date fair value of $47.15 per LTIP Unit that vest over a service period ending December 31, 2019. The fair value of the 2017 LTIP Units was estimated on the date of grant using a Monte Carlo Simulation model that assumed a risk free interest rate of 1.49% and an expected volatility of 20.75%.

On March 3, 2017, the Company granted 134,742 LTIP Units at a fair value of $66.57 per LTIP Unit that were fully vested on the grant date.

On May 30, 2017, the Company granted 25,000 non-qualified stock options with a grant date fair value of $10.02 that will vest on May 30, 2019. The Company measured the value of each option awarded using the Black-Scholes Option Pricing Model based upon the following assumptions: volatility of 30.19%, dividend yield of 4.93%, risk free rate of 2.08%, current value of $57.55 and an expected term of 8 years.

On June 1, 2017, the Company granted 1,522 LTIP Units with a grant date fair value of $58.31 per LTIP Unit that will vest in equal annual installments over a service period ending May 29, 2020. Concurrently, the Company granted 6,714 market-indexed LTIP Units at a grant date fair value of $39.66 per LTIP Unit that vest over a service period ending May 29, 2020. The fair value of the market-indexed LTIP Units was estimated on the date of grant using a Monte Carlo Simulation model that assumed a risk free interest rate of 1.45% and an expected volatility of 21.40%.

The following summarizes the compensation cost under the share and unit-based plans:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
LTIP Units	$5,269	$5,204	$24,892	$27,752
Stock awards	—	—	—	20
Stock units	1,002	965	4,947	5,339
Stock options	34	4	53	12
Phantom stock units	185	212	545	1,010
	$6,490	$6,385	$30,437	$34,133

The Company capitalized share and unit-based compensation costs of $983 and $750 for the three months ended September 30, 2017 and 2016, respectively, and $5,278 and $6,490 for the nine months ended September 30, 2017 and 2016, respectively. Unrecognized compensation costs of share and unit-based plans at September 30, 2017 consisted of $5,554 from LTIP Units, $4,338 from stock units, $208 from stock options and $466 from phantom stock units.

The following table summarizes the activity of the non-vested LTIP Units, phantom stock units and stock units:

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THE MACERICH COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, except per share amounts)
(Unaudited)
17. Share and Unit-Based Plans: (Continued)

	LTIP Units		Phantom Stock Units		Stock Units	
	Units	Value(1)	Units	Value(1)	Units	Value(1)
Balance at January 1, 2017	322,572	$ 58.18	5,845	$ 81.47	148,428	$ 78.53
Granted	506,906	55.33	8,439	68.34	86,426	66.47
Vested	(134,742)	66.57	(8,166)	71.85	(80,804)	75.67
Forfeited	—	—	—	—	(2,695)	69.57
Balance at September 30, 2017	694,736	$ 54.48	6,118	$ 76.20	151,355	$ 73.32

(1) Value represents the weighted average grant date fair value.

The following table summarizes the activity of the stock appreciations rights ("SARs") and stock options outstanding:

	SARs		Stock Options	
	Units	Value(1)	Units	Value(1)
Balance at January 1, 2017	284,146	$ 53.85	10,565	$ 56.77
Granted	—	—	25,000	57.55
Exercised	—	—	—	—
Balance at September 30, 2017	284,146	$ 53.85	35,565	$ 57.32

(1) Value represents the weighted average exercise price.
18. Income Taxes:
The Company has made taxable REIT subsidiary elections for all of its corporate subsidiaries other than its qualified REIT subsidiaries. The elections, effective for the year beginning January 1, 2001 and future years, were made pursuant to Section 856(l) of the Code. The Company's taxable REIT subsidiaries ("TRSs") are subject to corporate level income taxes which are provided for in the Company's consolidated financial statements. The Company's primary TRSs include Macerich Management Company and Macerich Arizona Partners LLC.
The income tax provision of the TRSs are as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
Current	$—	$(68)	$—	$(154)
Deferred	(2,869)	(837)	178	(2,582)
Income tax (expense) benefit	$(2,869)	$(905)	$178	$(2,736)

The net operating loss carryforwards are currently scheduled to expire through 2035, beginning in 2024. Net deferred tax assets of $44,964 and $38,301 were included in deferred charges and other assets, net at September 30, 2017 and December 31, 2016, respectively.
The tax years 2013 through 2016 remain open to examination by the taxing jurisdictions to which the Company is subject. The Company does not expect that the total amount of unrecognized tax benefit will materially change within the next twelve months.

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THE MACERICH COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, except per share amounts)
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19. Subsequent Events:

On October 13, 2017, the Company entered into a loan commitment with a lender to replace the existing loan on Santa Monica Place (See Note 8—Mortgage Notes Payable) with a new $300,000 five-year floating rate loan. The new loan is expected to close in the fourth quarter of 2017. The Company expects to use the excess proceeds to pay down its line of credit.

On October 19, 2017, the Company's joint venture in Chandler Fashion Center and Freehold Raceway Mall (See Note 10—Co-Venture Arrangement) replaced the existing loan on Freehold Raceway Mall with a new $400,000 loan that bears interest at 3.90% and matures on November 1, 2029. The Company used its share of the net proceeds to pay down its line of credit and for general corporate purposes.

On October 24, 2017, the Company announced a dividend/distribution of $0.74 per share for common stockholders and OP Unit holders of record on November 10, 2017. All dividends/distributions will be paid 100% in cash on December 1, 2017.

On November 1, 2017, the Company paid off in full the mortgage loan payable on Stonewood Center (See Note 8—Mortgage Notes Payable). The Company funded the repayment of the mortgage loan payable from borrowings under its line of credit.

On November 2, 2017, the Company entered into a loan commitment with a lender to place an $88,000 ten-year floating rate loan on Inland Center. The financing is expected to close in the fourth quarter of 2017. The Company expects to use the loan proceeds to pay down its line of credit.

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

IMPORTANT INFORMATION RELATED TO FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q of The Macerich Company (the "Company") contains or incorporates statements that constitute forward-looking statements within the meaning of the federal securities laws. Any statements that do not relate to historical or current facts or matters are forward-looking statements. You can identify some of the forward-looking statements by the use of forward-looking words, such as "may," "will," "could," "should," "expects," "anticipates," "intends," "projects," "predicts," "plans," "believes," "seeks," "estimates," "scheduled" and variations of these words and similar expressions. Statements concerning current conditions may also be forward-looking if they imply a continuation of current conditions. Forward-looking statements appear in a number of places in this Form 10-Q and include statements regarding, among other matters:

- expectations regarding the Company's growth;
- the Company's beliefs regarding its acquisition, redevelopment, development, leasing and operational activities and opportunities, including the performance of its retailers;
- the Company's acquisition, disposition and other strategies;
- regulatory matters pertaining to compliance with governmental regulations;
- the Company's capital expenditure plans and expectations for obtaining capital for expenditures;
- the Company's expectations regarding income tax benefits;
- the Company's expectations regarding its financial condition or results of operations; and
- the Company's expectations for refinancing its indebtedness, entering into and servicing debt obligations and entering into joint venture arrangements.

Stockholders are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks, uncertainties and other factors that may cause actual results, performance or achievements of the Company or the industry to differ materially from the Company's future results, performance or achievements, or those of the industry, expressed or implied in such forward-looking statements. Such factors include, among others, general industry, as well as national, regional and local economic and business conditions, which will, among other things, affect demand for retail space or retail goods, availability and creditworthiness of current and prospective tenants, anchor or tenant bankruptcies, closures, mergers or consolidations, lease rates, terms and payments, interest rate fluctuations, availability, terms and cost of financing and operating expenses; adverse changes in the real estate markets including, among other things, competition from other companies, retail formats and technology, risks of real estate development and redevelopment, acquisitions and dispositions; the liquidity of real estate investments, governmental actions and initiatives (including legislative and regulatory changes); environmental and safety requirements; and terrorist activities or other acts of violence which could adversely affect all of the above factors. You are urged to carefully review the disclosures we make concerning these risks and other factors that may affect our business and operating results, under "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016, as well as our other reports filed with the Securities and Exchange Commission (the "SEC"), which disclosures are incorporated herein by reference. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document. The Company does not intend, and undertakes no obligation, to update any forward-looking information to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events, unless required by law to do so.

Management's Overview and Summary

The Company is involved in the acquisition, ownership, development, redevelopment, management and leasing of regional and community/power shopping centers located throughout the United States. The Company is the sole general partner of, and owns a majority of the ownership interests in, The Macerich Partnership, L.P. (the "Operating Partnership"). As of September 30, 2017, the Operating Partnership owned or had an ownership interest in 48 regional shopping centers and seven community/power shopping centers aggregating approximately 54 million square feet of gross leasable area. These 55 regional and community/power shopping centers are referred to hereinafter as the "Centers," unless the context otherwise requires. The Company is a self-administered and self-managed real estate investment trust ("REIT") and conducts all of its operations through the Operating Partnership and the Management Companies.

The following discussion is based primarily on the consolidated financial statements of the Company for the three and nine months ended September 30, 2017 and 2016. It compares the results of operations for the three months ended September 30, 2017 to the results of operations for the three months ended September 30, 2016. It also compares the results of operations and cash flows for the nine months ended September 30, 2017 to the results of operations and cash flows for the

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nine months ended September 30, 2016. This information should be read in conjunction with the accompanying consolidated financial statements and notes thereto.

Acquisitions and Dispositions:

The financial statements reflect the following acquisitions, dispositions and changes in ownership subsequent to the occurrence of each transaction.

On January 6, 2016, the Company sold a 40% ownership interest in Arrowhead Towne Center, a 1,197,000 square foot regional shopping center in Glendale, Arizona, for $289.5 million, resulting in a gain on the sale of assets of $101.6 million. The sales price was funded by a cash payment of $129.5 million and the assumption of a pro rata share of the mortgage note payable on the property of $160.0 million. The Company used the cash proceeds from the sale to pay down its line of credit and for general corporate purposes, which included funding the Special Dividend (See "Other Events and Transactions"). Upon completion of the sale of the ownership interest, the Company no longer has a controlling interest in the joint venture due to the substantive participation rights of the outside partner. Accordingly, the Company accounts for its investment in Arrowhead Towne Center under the equity method of accounting.

On January 14, 2016, the Company formed a joint venture, whereby the Company sold a 49% ownership interest in Deptford Mall, a 1,040,000 square foot regional shopping center in Deptford, New Jersey; FlatIron Crossing, a 1,432,000 square foot regional shopping center in Broomfield, Colorado; and Twenty Ninth Street, an 847,000 square foot regional shopping center in Boulder, Colorado (the "MAC Heitman Portfolio"), for $771.5 million, resulting in a gain on the sale of assets of $340.7 million. The sales price was funded by a cash payment of $478.6 million and the assumption of a pro rata share of the mortgage notes payable on the properties of $292.9 million. The Company used the cash proceeds from the sale to pay down its line of credit and for general corporate purposes. Upon completion of the sale of the ownership interest, the Company no longer has a controlling interest in the joint venture due to the substantive participation rights of the outside partner. Accordingly, the Company accounts for its investment in the MAC Heitman Portfolio under the equity method of accounting.

The sale of ownership interests in the Arrowhead Towne Center and the MAC Heitman Portfolio are collectively referred to herein as the Joint Venture Transactions.

On March 1, 2016, the Company through a 50/50 joint venture, acquired Country Club Plaza, a 1,001,000 square foot regional shopping center in Kansas City, Missouri, for a purchase price of $660.0 million. The Company funded its pro rata share of $330.0 million with borrowings under its line of credit.

On April 13, 2016, the Company sold Capitola Mall, a 586,000 square foot regional shopping center in Capitola, California, for $93.0 million, resulting in a gain on the sale of assets of $24.9 million. The Company used the proceeds from the sale to pay down its line of credit and for general corporate purposes.

On May 31, 2016, the Company sold a former Mervyn's store in Yuma, Arizona, for $3.2 million, resulting in a loss on the sale of assets of $3.1 million. The Company used the proceeds from the sale to pay down its line of credit and for general corporate purposes.

On January 18, 2017, the Company sold Cascade Mall, a 589,000 square foot regional shopping center in Burlington, Washington; and Northgate Mall, a 750,000 square foot regional shopping center in San Rafael, California, in a combined transaction for $170.0 million, resulting in a gain on the sale of assets of $59.7 million. The proceeds were used to payoff the mortgage note payable on Northgate Mall and to repurchase shares of the Company's common stock under the 2017 Stock Buyback Program (See "Other Transactions and Events").

On March 17, 2017, the Company's joint venture in Country Club Plaza sold an office building for $78.0 million, resulting in a gain on sale of assets of $4.6 million. The Company's pro rata share of the gain on sale of assets of $2.3 million was included in equity in income from joint ventures. The Company used its share of the proceeds to fund repurchases under the 2017 Stock Buyback Program (See "Other Transactions and Events").

On September 18, 2017, the Company's joint venture in Fashion District Philadelphia sold an office building for $61.5 million, resulting in a gain on sale of assets of $13.4 million. The Company's pro rata share of the gain on sale of assets of $6.7 million was included in equity in income from joint ventures. The Company used its share of the proceeds to fund repurchases under the 2017 Stock Buyback Program (See "Other Transactions and Events").

Financing Activities:
On January 6, 2016, the Company replaced the existing loan on Arrowhead Towne Center with a new $400.0 million loan that bears interest at an effective rate of 4.05% and matures on February 1, 2028, which resulted in a loss of $3.6 million on the early extinguishment of debt. Concurrently, a 40% interest in the loan was assumed by a third party in connection with the sale of a 40% ownership interest in the underlying property (See "Acquisitions and Dispositions").
On January 14, 2016, the Company placed a $150.0 million loan on Twenty Ninth Street that bears interest at an effective rate of 4.10% and matures on February 6, 2026. Concurrently, a 49% interest in the loan was assumed by a third party in connection with the sale of a 49% ownership interest in the MAC Heitman Portfolio (See "Acquisitions and Dispositions").
On March 28, 2016, the Company's joint venture in Country Club Plaza placed a $320.0 million loan on the property that bears interest at an effective rate of 3.88% and matures on April 1, 2026. The Company used its share of the proceeds to pay down its line of credit and for general corporate purposes.
On May 27, 2016, the Company's joint venture in The Shops at North Bridge replaced the existing loan on the property with a new $375.0 million loan that bears interest at an effective rate of 3.71% and matures on June 1, 2028. The Company used its share of the excess proceeds to pay down its line of credit and for general corporate purposes.
On July 6, 2016, the Company modified and amended its line of credit. The amended $1.5 billion line of credit bears interest at LIBOR plus a spread of 1.30% to 1.90%, depending on the Company's overall leverage level, and matures on July 6, 2020 with a one-year extension option. Based on the Company's leverage level as of the amendment date, the initial borrowing rate on the facility was LIBOR plus 1.33%. The line of credit can be expanded, depending on certain conditions, up to a total facility of $2.0 billion.
On August 5, 2016, the Company’s joint venture in The Village at Corte Madera replaced the existing loan on the property with a new $225.0 million loan that bears interest at an effective rate of 3.53% and matures on September 1, 2028. The Company used its share of the excess proceeds to pay down its line of credit and for general corporate purposes.
On October 6, 2016, the Company placed a $325.0 million loan on Fresno Fashion Fair that bears interest at an effective rate of 3.67% and matures on November 1, 2026. The Company used the proceeds to pay down its line of credit and for general corporate purposes.
On February 1, 2017, the Company's joint venture in West Acres replaced the existing loan on the property with a new $80.0 million loan that bears interest at an effective rate of 4.61% and matures on March 1, 2032. The Company used its share of the excess proceeds to pay down its line of credit and for general corporate purposes.
On March 16, 2017, the Company's joint venture in Kierland Commons replaced the existing loan on the property with a new $225.0 million loan that bears interest at an effective rate of 3.98% and matures on April 1, 2027. The Company used its share of the excess proceeds to pay down its line of credit and for general corporate purposes.
On September 29, 2017, the Company placed a new $110.0 million loan on Green Acres Commons that bears interest at LIBOR plus 2.15% and matures on March 29, 2021. The loan can be expanded, depending on certain conditions, up to $130.0 million. At September 30, 2017, the total interest rate was 3.96%. The Company used the proceeds to pay down its line of credit and for general corporate purposes.
On October 13, 2017, the Company entered into a loan commitment with a lender to replace the existing loan on Santa Monica Place with a new $300.0 million five-year floating rate loan. The new loan is expected to close in the fourth quarter of 2017. The Company expects to use the excess proceeds to pay down its line of credit.
On October 19, 2017, the Company's joint venture in Chandler Fashion Center and Freehold Raceway Mall replaced the existing loan on the Freehold Raceway Mall with a new $400.0 million loan that bears interest at 3.90% and matures on November 1, 2029. The Company used its share of the net proceeds to pay down its line of credit and for general corporate purposes.
On November 1, 2017, the Company paid off in full the $95.0 million mortgage loan payable on Stonewood Center. The Company funded the repayment of the mortgage loan payable from borrowings under its line of credit.
On November 2, 2017, the Company entered into a loan commitment with a lender to place an $88.0 million ten-year floating rate loan on Inland Center. The financing is expected to close in the fourth quarter of 2017. The Company

expects to use the loan proceeds to pay down its line of credit.

Redevelopment and Development Activities:
The Company's joint venture is proceeding with the development of Fashion District Philadelphia, a redevelopment of an 850,000 square foot shopping center in Philadelphia, Pennsylvania. The project is expected to be completed in 2018. The total cost of the project is estimated to be between $305.0 million and $365.0 million, with $152.5 million to $182.5 million estimated to be the Company's pro rata share. The Company has funded $111.7 million of the total $223.4 million incurred by the joint venture as of September 30, 2017.
The Company is currently in the process of redeveloping the 250,000 square foot former Sears store at Kings Plaza Shopping Center. The Company expects to complete the project in 2018. As of September 30, 2017, the Company has incurred $40.4 million in costs and anticipates the total cost of the project to be between $95.0 million and $100.0 million.
Other Transactions and Events:
On September 30, 2015, the Company's Board of Directors authorized the repurchase of up to $1.2 billion of the Company's outstanding common shares over the period ending September 30, 2017, as market conditions warrant. On November 12, 2015, the Company entered into an accelerated share repurchase program ("ASR") to repurchase $400.0 million of the Company's common stock. In accordance with the ASR, the Company made a prepayment of $400.0 million and received an initial share delivery of 4,140,788 shares. On January 19, 2016, the ASR was completed and the Company received delivery of an additional 970,609 shares. The average price of the 5,111,397 shares repurchased under the ASR was $78.26 per share. The ASR was funded from proceeds in connection with the financing and sale of a 40% ownership interest in Pacific Premier Retail LLC (the "PPR Portfolio").
On October 30, 2015, the Company declared two special dividends/distributions ("Special Dividend"), each of $2.00 per share of common stock and per OP Unit. The first Special Dividend was paid on December 8, 2015 to stockholders and OP Unit holders of record on November 12, 2015. The second Special Dividend was paid on January 6, 2016 to common stockholders and OP Unit holders of record on November 12, 2015. The Special Dividends were funded from proceeds in connection with the financing and sale of ownership interests in the PPR Portfolio and Arrowhead Towne Center (See "Acquisitions and Dispositions" and "Financing Activity").
On February 17, 2016, the Company entered into an ASR to repurchase $400.0 million of the Company's common stock. In accordance with the ASR, the Company made a prepayment of $400.0 million and received an initial share delivery of 4,222,193 shares. On April 19, 2016, the ASR was completed and the Company received delivery of an additional 861,235 shares. The average price of the 5,083,428 shares repurchased under the ASR was $78.69 per share. The ASR was funded from borrowings under the Company's line of credit, which had been paid down from the proceeds from the Joint Venture Transactions (See "Acquisitions and Dispositions" and "Financing Activity").
On May 9, 2016, the Company entered into an ASR to repurchase the remaining $400.0 million of the Company's common stock authorized for repurchase. In accordance with the ASR, the Company made a prepayment of $400.0 million and received an initial share delivery of 3,964,812 shares. On July 11, 2016, the ASR was completed and the Company received delivery of an additional 1,104,162 shares. The average price of the 5,068,974 shares repurchased under the ASR was $78.91 per share. The ASR was funded from borrowings under the Company's line of credit, which had been paid down from the proceeds from the Joint Venture Transactions (See "Acquisitions and Dispositions" and "Financing Activity"). The total number of shares repurchased under the $1.2 billion stock buyback program was 15,263,799 at an average price of $78.62.
On July 15, 2016, the Company conveyed Flagstaff Mall, a 347,000 square foot regional shopping center in Flagstaff, Arizona, to the mortgage lender by a deed-in-lieu of foreclosure and was discharged from the mortgage note payable. The mortgage note payable was a non-recourse loan. As a result, the Company recognized a gain of $5.3 million on the extinguishment of debt.
On February 12, 2017, the Company's Board of Directors authorized the repurchase of up to $500.0 million of its outstanding common shares as market conditions and the Company’s liquidity warrant. Repurchases may be made through open market purchases, privately negotiated transactions, structured or derivative transactions, including ASR transactions, or other methods of acquiring shares and pursuant to Rule 10b5-1 of the Securities Act of 1934, from time to time as permitted by securities laws and other legal requirements. During the period from February 12, 2017 to September 30, 2017, the Company repurchased a total of 3,627,390 of its common shares for $221.4 million,

representing an average price of $61.01 per share. The Company funded the repurchases from the net proceeds of the sale of Cascade Mall and Northgate Mall (See "Acquisitions and Dispositions"), its share of the proceeds from the sale of office buildings at Fashion District Philadelphia and Country Club Plaza (See "Acquisitions and Dispositions") and from borrowings under its line of credit.

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Inflation:

In the last five years, inflation has not had a significant impact on the Company because of a relatively low inflation rate. Most of the leases at the Centers have rent adjustments periodically throughout the lease term. These rent increases are either in fixed increments or based on using an annual multiple of increases in the Consumer Price Index ("CPI"). In addition, approximately 6% to 13% of the leases for spaces 10,000 square feet and under expire each year, which enables the Company to replace existing leases with new leases at higher base rents if the rents of the existing leases are below the then existing market rate. The Company has generally entered into leases that require tenants to pay a stated amount for operating expenses, generally excluding property taxes, regardless of the expenses actually incurred at any Center, which places the burden of cost control on the Company. Additionally, certain leases require the tenants to pay their pro rata share of operating expenses.

Seasonality:

The shopping center industry is seasonal in nature, particularly in the fourth quarter during the holiday season when retailer occupancy and retail sales are typically at their highest levels. In addition, shopping malls achieve a substantial portion of their specialty (temporary retailer) rents during the holiday season and the majority of percentage rent is recognized in the fourth quarter. As a result of the above, earnings are generally higher in the fourth quarter.

Critical Accounting Policies

The preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Some of these estimates and assumptions include judgments on revenue recognition, estimates for common area maintenance and real estate tax accruals, provisions for uncollectible accounts, impairment of long-lived assets, the allocation of purchase price between tangible and intangible assets, capitalization of costs and fair value measurements. The Company's significant accounting policies are described in more detail in Note 2—Summary of Significant Accounting Policies in the Company's Notes to the Consolidated Financial Statements. However, the following policies are deemed to be critical.

Revenue Recognition:

Minimum rental revenues are recognized on a straight-line basis over the term of the related lease. The difference between the amount of rent due in a year and the amount recorded as rental income is referred to as the "straight line rent adjustment." Currently, 50% of the mall store and freestanding store leases contain provisions for CPI rent increases periodically throughout the term of the lease. The Company believes that using an annual multiple of CPI increases, rather than fixed contractual rent increases, results in revenue recognition that more closely matches the cash revenue from each lease and will provide more consistent rent growth throughout the term of the leases. Percentage rents are recognized when the tenants' specified sales targets have been met. Estimated recoveries from certain tenants for their pro rata share of real estate taxes, insurance and other shopping center operating expenses are recognized as revenues in the period the applicable expenses are incurred. Other tenants pay a fixed rate and these tenant recoveries are recognized as revenues on a straight-line basis over the term of the related leases.

Property:

Maintenance and repair expenses are charged to operations as incurred. Costs for major replacements and betterments, which includes HVAC equipment, roofs, parking lots, etc., are capitalized and depreciated over their estimated useful lives. Gains and losses are recognized upon disposal or retirement of the related assets and are reflected in earnings. Property is recorded at cost and is depreciated using a straight-line method over the estimated useful lives of the assets as follows:

Buildings and improvements	5 - 40 years
Tenant improvements	5 - 7 years
Equipment and furnishings	5 - 7 years

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Capitalization of Costs:
The Company capitalizes costs incurred in redevelopment, development, renovation and improvement of properties. The capitalized costs include pre-construction costs essential to the development of the property, development costs, construction costs, interest costs, real estate taxes, salaries and related costs and other costs incurred during the period of development. These capitalized costs include direct and certain indirect costs clearly associated with the project. Indirect costs include real estate taxes, insurance and certain shared administrative costs. In assessing the amounts of direct and indirect costs to be capitalized, allocations are made to projects based on estimates of the actual amount of time spent on each activity. Indirect costs not clearly associated with specific projects are expensed as period costs. Capitalized indirect costs are allocated to development and redevelopment activities based on the square footage of the portion of the building not held available for immediate occupancy. If costs and activities incurred to ready the vacant space cease, then cost capitalization is also discontinued until such activities are resumed. Once work has been completed on a vacant space, project costs are no longer capitalized. For projects with extended lease-up periods, the Company ends the capitalization when significant activities have ceased, which does not exceed the shorter of a one-year period after the completion of the building shell or when the construction is substantially complete.
Acquisitions:
The Company allocates the estimated fair value of acquisitions to land, building, tenant improvements and identified intangible assets and liabilities, based on their estimated fair values. In addition, any assumed mortgage notes payable are recorded at their estimated fair values. The estimated fair value of the land and buildings is determined utilizing an "as if vacant" methodology. Tenant improvements represent the tangible assets associated with the existing leases valued on a fair value basis at the acquisition date prorated over the remaining lease terms. The tenant improvements are classified as an asset under property and are depreciated over the remaining lease terms. Identifiable intangible assets and liabilities relate to the value of in-place operating leases which come in three forms: (i) leasing commissions and legal costs, which represent the value associated with "cost avoidance" of acquiring in-place leases, such as lease commissions paid under terms generally experienced in the Company's markets; (ii) value of in-place leases, which represents the estimated loss of revenue and of costs incurred for the period required to lease the "assumed vacant" property to the occupancy level when purchased; and (iii) above or below-market value of in-place leases, which represents the difference between the contractual rents and market rents at the time of the acquisition, discounted for tenant credit risks. Leasing commissions and legal costs are recorded in deferred charges and other assets and are amortized over the remaining lease terms. The value of in-place leases are recorded in deferred charges and other assets and amortized over the remaining lease terms plus any below-market fixed rate renewal options. Above or below-market leases are classified in deferred charges and other assets or in other accrued liabilities, depending on whether the contractual terms are above or below-market, and the asset or liability is amortized to minimum rents over the remaining terms of the leases. The remaining lease terms of below-market leases may include certain below-market fixed-rate renewal periods. In considering whether or not a lessee will execute a below-market fixed-rate lease renewal option, the Company evaluates economic factors and certain qualitative factors at the time of acquisition such as tenant mix in the Center, the Company's relationship with the tenant and the availability of competing tenant space. The initial allocation of purchase price is based on management's preliminary assessment, which may change when final information becomes available. Subsequent adjustments made to the initial purchase price allocation are made within the allocation period, which does not exceed one year. The purchase price allocation is described as preliminary if it is not yet final. The use of different assumptions in the allocation of the purchase price of the acquired assets and liabilities assumed could affect the timing of recognition of the related revenues and expenses.
The Company immediately expenses costs associated with business combinations as period costs.
Remeasurement gains are recognized when the Company obtains control of an existing equity method investment to the extent that the fair value of the existing equity investment exceeds the carrying value of the investment.
Asset Impairment:
The Company assesses whether an indicator of impairment in the value of its properties exists by considering expected future operating income, trends and prospects, as well as the effects of demand, competition and other economic factors. Such factors include projected rental revenue, operating costs and capital expenditures as well as

estimated holding periods and capitalization rates. If an impairment indicator exists, the determination of recoverability is made based upon the estimated undiscounted future net cash flows, excluding interest expense. The amount of impairment loss, if any, is determined by comparing the fair value, as determined by a discounted cash flows analysis or a contracted sales price, with the carrying value of the related assets. The Company generally holds and operates its properties long-term, which decreases the likelihood of their carrying values not being recoverable. Properties classified as held for sale are measured at the lower of the carrying amount or fair value less cost to sell.

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The Company reviews its investments in unconsolidated joint ventures for a series of operating losses and other factors that may indicate that a decrease in the value of its investments has occurred which is other-than-temporary. The investment in each unconsolidated joint venture is evaluated periodically, and as deemed necessary, for recoverability and valuation declines that are other-than-temporary.

Fair Value of Financial Instruments:

The fair value hierarchy distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity and the reporting entity's own assumptions about market participant assumptions.

Level 1 inputs utilize quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, which is typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The Company calculates the fair value of financial instruments and includes this additional information in the notes to consolidated financial statements when the fair value is different than the carrying value of those financial instruments. When the fair value reasonably approximates the carrying value, no additional disclosure is made.

Deferred Charges:

Costs relating to obtaining tenant leases are deferred and amortized over the initial term of the agreement using the straight-line method. As these deferred leasing costs represent productive assets incurred in connection with the Company's provision of leasing arrangements at the Centers, the related cash flows are classified as investing activities within the Company's consolidated statements of cash flows. Costs relating to financing of shopping center properties are deferred and amortized over the life of the related loan using the straight-line method, which approximates the effective interest method. The ranges of the terms of the agreements are as follows:

Deferred lease costs	1 - 15 years
Deferred financing costs	1 - 15 years

Results of Operations

Many of the variations in the results of operations, discussed below, occurred because of the transactions affecting the Company's properties described in Management's Overview and Summary above, including the Redevelopment Properties, the Joint Venture Centers and the Disposition Properties (as defined below).

For purposes of the discussion below, the Company defines "Same Centers" as those Centers that are substantially complete and in operation for the entirety of both periods of the comparison. Non-Same Centers for comparison purposes include those Centers or properties that are going through a substantial redevelopment often resulting in the closing of a portion of the Center (“Redevelopment Properties”), those properties that have recently transitioned to or from equity method joint ventures to consolidated assets ("Joint Venture Centers") and properties that have been disposed of ("Disposition Properties"). The Company moves a Center in and out of Same Centers based on whether the Center is substantially complete and in operation for the entirety of both periods of the comparison. Accordingly, the Same Centers consist of all consolidated Centers, excluding the Redevelopment Properties, the Joint Venture Centers and the Disposition Properties for the periods of comparison.

For the comparison of the three and nine months ended September 30, 2017 to the three and nine months ended September 30, 2016, the Redevelopment Properties are the expansion portion of Green Acres Mall, Paradise Valley Mall and Westside Pavilion.

For the comparison of the nine months ended September 30, 2017 to the nine months ended September 30, 2016, the Joint Venture Centers are Arrowhead Towne Center and the MAC Heitman Portfolio. The change in revenues and expenses at the Joint Venture Centers is primarily due to the conversion of Arrowhead Towne Center and the MAC Heitman Portfolio from

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consolidated Centers to unconsolidated joint ventures. There are no Joint Venture Centers for the three months ended September 30, 2017 and 2016.

For comparison of the three and nine months ended September 30, 2017 to the three and nine months ended September 30, 2016, the Disposition Properties are Cascade Mall, Northgate Mall, Flagstaff Mall and Capitola Mall.

Unconsolidated joint ventures are reflected using the equity method of accounting. The Company's pro rata share of the results from these Centers is reflected in the Consolidated Statements of Operations as equity in income of unconsolidated joint ventures.

The Company considers tenant annual sales per square foot (for tenants in place for a minimum of twelve months or longer and 10,000 square feet and under), occupancy rates (excluding large retail stores or "Anchors") and releasing spreads (i.e. a comparison of initial average base rent per square foot on leases executed during the trailing twelve months to average base rent per square foot at expiration for the leases expiring during the trailing twelve months based on the spaces 10,000 square feet and under) to be key performance indicators of the Company's internal growth.

Tenant sales per square foot increased from $626 for the twelve months ended September 30, 2016 to $659 for the twelve months ended September 30, 2017. Occupancy rate decreased from 95.3% at September 30, 2016 to 94.3% at September 30, 2017. Releasing spreads increased 15.0% for the twelve months ended September 30, 2017. These calculations exclude Centers under development or redevelopment and property dispositions (See "Acquisitions and Dispositions" and "Other Transactions and Events" in Management's Overview and Summary).

Releasing spreads remained positive as the Company was able to lease available space at higher average rents than the expiring rental rates, resulting in a releasing spread of $7.54 per square foot ($57.71 on new and renewal leases executed compared to $50.17 on leases expiring), representing a 15.0% increase for the trailing twelve months ended September 30, 2017. The Company expects that releasing spreads will continue to be positive for the remainder of 2017 as it renews or relets leases that are scheduled to expire. These leases that are scheduled to expire represent 0.9 million square feet of the Centers, accounting for 11.3% of the gross leasable area ("GLA") of mall stores and freestanding stores, for spaces 10,000 square feet and under, as of September 30, 2017.

During the trailing twelve months ended September 30, 2017, the Company signed 218 new leases and 412 renewal leases comprising approximately 1.1 million square feet of GLA, of which 0.8 million square feet related to the consolidated Centers. The annual initial average base rent for new and renewal leases was $57.71 per square foot for the trailing twelve months ended September 30, 2017 with an average tenant allowance of $18.47 per square foot.

Comparison of Three Months Ended September 30, 2017 and 2016

Revenues:

Minimum and percentage rents (collectively referred to as "rental revenue") decreased by $10.1 million, or 6.4%, from 2016 to 2017. The decrease in rental revenue is attributed to a decrease of $7.0 million from the Redevelopment Properties and $3.7 million from the Disposition Properties offset in part by an increase of $0.6 million from the Same Centers. Rental revenue includes the amortization of above and below-market leases, the amortization of straight-line rents and lease termination income. The amortization of above and below-market leases decreased from $4.9 million in 2016 to $(0.7) million in 2017. The amortization of straight-line rents increased from $0.9 million in 2016 to $2.9 million in 2017. Lease termination income decreased from $7.7 million in 2016 to $3.1 million in 2017.

Tenant recoveries decreased $1.6 million, or 2.1%, from 2016 to 2017. This decrease in tenant recoveries is attributed to a decrease of $1.8 million from the Disposition Properties and $0.4 million from the Same Centers offset in part by an increase of $0.6 million from the Redevelopment Properties.

Management Companies' revenue increased from $9.0 million in 2016 to $10.1 million in 2017. The increase in Management Companies' revenue is primarily due to an increase in development fees from joint ventures.

Shopping Center and Operating Expenses:

Shopping center and operating expenses decreased $0.7 million, or 0.9%, from 2016 to 2017. The decrease in shopping center and operating expenses is attributed to a decrease of $2.6 million from the Disposition Properties offset in part by an increase of $1.5 million from the Same Centers and $0.4 million from the Redevelopment Properties.

Management Companies' Operating Expenses:

Management Companies' operating expenses decreased $1.2 million from 2016 to 2017 as a result of the conversion of Arrowhead Towne Center and the MAC Heitman Portfolio from consolidated centers to unconsolidated joint ventures in 2016 (See "Acquisitions and Dispositions" in Management's Overview and Summary).

REIT General and Administrative Expenses:

REIT general and administrative expenses decreased by $1.6 million from 2016 to 2017.

Depreciation and Amortization:

Depreciation and amortization decreased $3.8 million from 2016 to 2017. The decrease in depreciation and amortization is attributed to a decrease of $2.8 million from the Same Centers and $2.3 million from the Disposition Properties offset in part by an increase of $1.3 million from the Redevelopment Properties.

Interest Expense:

Interest expense increased $3.3 million from 2016 to 2017. The increase in interest expense is attributed to an increase of $2.2 million in interest expense from borrowings under the Company's line of credit and $1.9 million from the Same Centers offset in part by a decrease of $0.6 million from the Disposition Properties and $0.2 million from the Redevelopment Properties.

The above interest expense items are net of capitalized interest, which increased from $2.7 million in 2016 to $3.4 million in 2017.

Gain on Extinguishment of Debt, net:

The decrease in gain on extinguishment of debt, net of $5.3 million is due to the settlement of the mortgage note payable on Flagstaff Mall by a deed-in-lieu of foreclosure in 2016 (See “Other Transactions and Events” in Management’s Overview and Summary) with no comparable gain in 2017.

Equity in Income of Unconsolidated Joint Ventures:

Equity in income of unconsolidated joint ventures increased $12.7 million from 2016 to 2017. The increase in equity in income from unconsolidated joint ventures is primarily attributed to the Company's share of the gain on the sale of an office building at Fashion District Philadelphia in 2017 (See "Acquisitions and Dispositions" in Management's Overview and Summary).

(Loss) Gain on Sale or Write Down of Assets, net:

The loss on sale or write down of assets, net decreased $7.5 million from 2016 to 2017. The decrease in loss on sale or write down of assets, net is primarily due to an impairment loss of $23.3 million on the Promenade at Casa Grande in 2016 offset in part by an impairment loss of $12.0 million on Southridge Center in 2017 and a $2.6 million reduction of a contingent consideration obligation in 2016. The impairment losses on Promenade at Casa Grande and Southridge Center were due to the reduction in the estimated holding periods of the properties.

Net Income:

Net income increased $6.0 million from 2016 to 2017 primarily due to the $7.5 million decrease in loss on sale or write down of assets, net, as discussed above.

Funds From Operations ("FFO"):

Primarily as a result of the factors mentioned above, FFO attributable to common stockholders and unit holders—diluted decreased 9.5% from $160.3 million in 2016 to $145.0 million in 2017. For a reconciliation of FFO attributable to common stockholders and unit holders and FFO attributable to common stockholders and unit holders—diluted to net income attributable to the Company, the most directly comparable GAAP financial measure, see "Funds From Operations ("FFO")" below.

Comparison of Nine Months Ended September 30, 2017 and 2016

Revenues:

Rental revenue decreased by $16.6 million, or 3.5%, from 2016 to 2017. The decrease in rental revenue is attributed to a decrease of $14.3 million from the Disposition Properties, $9.8 million from the Redevelopment Properties and $3.3 million from the Joint Venture Centers offset in part by an increase of $10.8 million from the Same Centers. The amortization of above and below-market leases decreased from $9.1 million in 2016 to $0.4 million in 2017. The amortization of straight-line rents increased from $3.4 million in 2016 to $7.5 million in 2017. Lease termination income decreased from $15.5 million in 2016 to $13.5 million in 2017. The increase in rental revenue at the Same Centers is primarily due to an increase in lease termination income and an increase in leasing spreads.

Tenant recoveries decreased $16.3 million, or 7.1%, from 2016 to 2017. The decrease in tenant recoveries is attributed to a decrease of $7.2 million from the Same Centers, $6.7 million from the Disposition Properties, $1.6 million from the Joint Venture Centers and $0.8 million from the Redevelopment Properties. The decrease in tenant recoveries at the Same Centers is primarily due to a decrease in property tax expense and utility costs.

Management Companies' revenue increased from $28.9 million in 2016 to $32.0 million in 2017. The increase in Management Companies' revenue is due to an increase in development and leasing fees from joint ventures.

Shopping Center and Operating Expenses:

Shopping center and operating expenses decreased $7.0 million, or 3.1%, from 2016 to 2017. The decrease in shopping center and operating expenses is attributed to a decrease of $8.9 million from the Disposition Properties and $0.8 million from the Joint Venture Centers offset in part by an increase of $1.8 million from the Redevelopment Properties and $0.9 million from the Same Centers.

Management Companies' Operating Expenses:

Management Companies' operating expenses increased $1.3 million from 2016 to 2017.

REIT General and Administrative Expenses:

REIT general and administrative expenses decreased by $2.0 million from 2016 to 2017.

Depreciation and Amortization:

Depreciation and amortization decreased $9.6 million from 2016 to 2017. The decrease in depreciation and amortization is attributed to a decrease of $8.4 million from the Disposition Properties, $4.1 million from the Same Centers and $1.5 million from the Joint Venture Centers offset in part by an increase of $4.4 million from the Redevelopment Properties.

Interest Expense:

Interest expense increased $5.9 million from 2016 to 2017. The increase in interest expense was attributed to an increase of $5.8 million in interest expense from borrowings under the Company's line of credit and $4.4 million from the Same Centers offset in part by a decrease of $3.2 million from the Disposition Properties, $0.9 million from the Joint Venture Centers and $0.2 million from the Redevelopment Properties. The increase in interest expense at the Same Centers is primarily due to the new loan on Fresno Fashion Fair in 2016 (See "Financing Activities" in Management's Overview and Summary).

The above interest expense items are net of capitalized interest, which increased from $7.6 million in 2016 to $9.4 million in 2017.

Gain on Extinguishment of Debt, net:

Gain on extinguishment of debt, net decreased $1.7 million from 2016 to 2017. The decrease in gain on extinguishment of debt is due to the gain of $5.3 million on the settlement of the mortgage note payable on Flagstaff Mall by a deed-in-lieu of foreclosure in 2016 (See “Other Transactions and Events” in Management’s Overview and Summary) offset in part by a loss of $3.6 million on the early extinguishment of debt on Arrowhead Towne Center in 2016 (See “Financing Activities” in Management’s Overview and Summary).

Equity in Income of Unconsolidated Joint Ventures:

Equity in income of unconsolidated joint ventures increased $19.2 million from 2016 to 2017. The increase is primarily due to the conversion of Arrowhead Towne Center and the MAC Heitman Portfolio from consolidated Centers to unconsolidated joint ventures in 2016 (See "Acquisitions and Dispositions" in Management's Overview and Summary) and the

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Company's share of the gain on the sales of office buildings at Fashion District Philadelphia and Country Club Plaza in 2017 (See "Acquisitions and Dispositions" in Management's Overview and Summary).

Gain on Sale or Write Down of Assets, net:

The gain on sale or write down of assets, net decreased $388.8 million from 2016 to 2017. The decrease is primarily due to the gain on the sale of a 49% interest in the MAC Heitman Portfolio of $340.7 million in 2016, the gain on the sale of a 40% interest in Arrowhead Towne Center of $101.6 million in 2016, the gain of $24.9 million on the sale of Capitola Mall in 2016 and an impairment loss of $12.0 million on Southridge Center in 2017 offset in part by the gain of $59.7 million on the sale of Cascade Mall and Northgate Mall in 2017 (See "Acquisitions and Dispositions" in Management's Overview and Summary) and an impairment loss of $23.3 million on the Promenade at Casa Grande in 2016. The impairment losses on Southridge Center and Promenade at Casa Grande were due to the reduction in the estimated holding periods of the properties.

Net Income:

Net income decreased $390.9 million from 2016 to 2017. The decrease is primarily attributed to the decrease in the gain on sale or write down of assets, net of $388.8 million as discussed above.

Funds From Operations ("FFO"):

Primarily as a result of the factors mentioned above, FFO attributable to common stockholders and unit holders—diluted decreased 7.4% from $461.7 million in 2016 to $427.3 million in 2017. For a reconciliation of FFO attributable to common stockholders and unit holders and FFO attributable to common stockholders and unit holders—diluted to net income attributable to the Company, the most directly comparable GAAP financial measure, see "Funds From Operations ("FFO")" below.

Operating Activities:

Cash provided by operating activities decreased from $331.1 million in 2016 to $299.9 million in 2017. The decrease is primarily due to the changes in assets and liabilities and the results as discussed above.

Investing Activities:

Cash provided by investing activities decreased $330.2 million from 2016 to 2017. The decrease in cash provided by investing activities is primarily attributed to a decrease in cash proceeds from the sale of assets of $528.2 million and a decrease in distributions from unconsolidated joint ventures of $185.3 million offset in part by a decrease in contributions to unconsolidated joint ventures of $324.0 million and a decrease in development, redevelopment and renovation costs of $62.4 million.

The decrease in cash proceeds from the sale of assets is attributed to the sales of ownership interests in Arrowhead Towne Center and the MAC Heitman Portfolio in 2016 and the sale of Capitola Mall in 2016 offset in part by the sale of Cascade Mall and Northgate Mall in 2017 (See "Acquisitions and Dispositions" in Management's Overview and Summary). The decrease in contributions to unconsolidated joint ventures is primarily due to the acquisition of the 50% ownership interest in Country Club Plaza in 2016 (See "Acquisitions and Dispositions" in Management's Overview and Summary).

Financing Activities:

Cash used in financing activities decreased $340.8 million from 2016 to 2017. The decrease in cash used in financing activities is primarily due to a decrease in payments on mortgages, bank and other notes payable of $1.6 billion, a decrease in the repurchases of the Company's common stock of $578.6 million (See "Other Transactions and Events" in Management's Overview and Summary) and a decrease in cash dividends and distributions of $339.1 million offset in part by a decrease in proceeds from mortgages, bank and other notes payable of $2.2 billion.

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Liquidity and Capital Resources

The Company anticipates meeting its liquidity needs for its operating expenses, debt service and dividend requirements for the next twelve months through cash generated from operations, working capital reserves and/or borrowings under its unsecured line of credit. The following tables summarize capital expenditures incurred at the Centers (at the Company's pro rata share):

(Dollars in thousands)	For the Nine Months Ended September 30, 2017	2016
Consolidated Centers:		
Acquisitions of property and equipment	$19,712	$24,638
Development, redevelopment, expansion and renovation of Centers	86,287	113,812
Tenant allowances	9,081	13,752
Deferred leasing charges	19,243	18,745
	$134,323	$170,947
Joint Venture Centers:		
Acquisitions of property and equipment	$6,549	$341,053
Development, redevelopment, expansion and renovation of Centers	92,514	73,797
Tenant allowances	4,650	7,740
Deferred leasing charges	4,666	5,619
	$108,379	$428,209

The Company expects amounts to be incurred during the next twelve months for tenant allowances and deferred leasing charges to be comparable or less than 2016 and that capital for those expenditures will be available from working capital, cash flow from operations, borrowings on property specific debt or unsecured corporate borrowings. The Company expects to incur between $200.0 million and $300.0 million during the next twelve months for development, redevelopment, expansion and renovations. Capital for these major expenditures, developments and/or redevelopments has been, and is expected to continue to be, obtained from a combination of debt or equity financings, which are expected to include borrowings under the Company's line of credit and construction loans.

The Company has also generated liquidity in the past, and may continue to do so in the future, through equity offerings and issuances, property refinancings, joint venture transactions and the sale of non-core assets. For example, the Company's recently completed sale of Cascade Mall and Northgate Mall (See "Acquisitions and Dispositions" in Management's Overview and Summary), sales of office buildings at Fashion District Philadelphia and Country Club Plaza in 2017 (See "Acquisitions and Dispositions" in Management's Overview and Summary) and the Joint Venture Transactions (See "Acquisitions and Dispositions" in Management's Overview and Summary), which included new debt or refinancings of existing debt on the properties (See "Financing Activities" in Management's Overview and Summary). The Company used these proceeds to pay down its line of credit, fund the Special Dividend (See "Other Transactions and Events" in Management's Overview and Summary) and for other general corporate purposes, which included the repurchases of the Company's common stock under the 2015 Stock Buyback Program and the 2017 Stock Buyback Program (See "Other Transactions and Events" in Management's Overview and Summary). Furthermore, the Company has filed a shelf registration statement, which registered an unspecified amount of common stock, preferred stock, depositary shares, debt securities, warrants, rights, stock purchase contracts and units that may be sold from time to time by the Company. The Company expects any additional repurchases of the Company's common stock under the 2017 Stock Buyback Program to be funded by future sales of non-core assets, borrowings under its line of credit and/or refinancing transactions.

The capital and credit markets can fluctuate and, at times, limit access to debt and equity financing for companies. As demonstrated by the Company's recent activity as discussed below, the Company has been able to access capital; however, there is no assurance the Company will be able to do so in future periods or on similar terms and conditions. Many factors impact the Company's ability to access capital, such as its overall debt level, interest rates, interest coverage ratios and prevailing market conditions. In the event that the Company has significant tenant defaults as a

result of the overall economy and general market conditions, the Company could have a decrease in cash flow from operations, which could result in increased borrowings under its line of credit. These events could result in an increase in the Company's proportion of floating rate debt, which would cause it to be subject to interest rate fluctuations in the future.

The Company had an equity distribution agreement with a number of sales agents (the "ATM Program") to issue and sell, from time to time, shares of common stock, par value $0.01 per share, having an aggregate offering price of up to $500 million (the "ATM Shares"). Sales of the ATM Shares could have been made in privately negotiated transactions and/or any other method permitted by law, including sales deemed to be an "at the market" offering, which included sales made directly on the New York Stock Exchange or sales made to or through a market maker other than on an exchange. The ATM program expired by its term in August 2017. The Company did not sell any shares under the ATM Program.

The Company's total outstanding loan indebtedness at September 30, 2017 was $7.7 billion (consisting of $5.1 billion of consolidated debt, less $229.6 million of noncontrolling interests, plus $2.8 billion of its pro rata share of unconsolidated joint venture debt). The majority of the Company's debt consists of fixed-rate conventional mortgage notes collateralized by individual properties. The Company expects that all of the maturities during the next twelve months will be refinanced, restructured, extended and/or paid off from the Company's line of credit or cash on hand.

The Company believes that the pro rata debt provides useful information to investors regarding its financial condition because it includes the Company's share of debt from unconsolidated joint ventures and, for consolidated debt, excludes the Company's partners' share from consolidated joint ventures, in each case presented on the same basis. The Company has several significant joint ventures and presenting its pro rata share of debt in this manner can help investors better understand the Company's financial condition after taking into account our economic interest in these joint ventures. The Company's pro rata share of debt should not be considered as a substitute for the Company's total consolidated debt determined in accordance with GAAP or any other GAAP financial measures and should only be considered together with and as a supplement to the Company's financial information prepared in accordance with GAAP.

The Company has a $1.5 billion revolving line of credit facility that bears interest at LIBOR plus a spread of 1.30% to 1.90%, depending on the Company's overall leverage level, and matures on July 6, 2020 with a one-year extension option. The line of credit can be expanded, depending on certain conditions, up to a total facility of $2.0 billion. All obligations under the facility are unconditionally guaranteed only by the Company. Based on the Company's leverage level as of September 30, 2017, the borrowing rate on the facility was LIBOR plus 1.45%. At September 30, 2017, total borrowings under the line of credit were $1.0 billion less unamortized deferred finance costs of $8.2 million with a total interest rate of 3.01%.

Cash dividends and distributions for the nine months ended September 30, 2017 were $328.7 million. A total of $299.9 million was funded by operations. The remaining $28.9 million was funded from distributions from unconsolidated joint ventures, which were included in the cash flows from investing activities section of the Company's Consolidated Statement of Cash Flows.

At September 30, 2017, the Company was in compliance with all applicable loan covenants under its agreements.

At September 30, 2017, the Company had cash and cash equivalents of $71.1 million.

Off-Balance Sheet Arrangements:

The Company accounts for its investments in joint ventures that it does not have a controlling interest or is not the primary beneficiary using the equity method of accounting and those investments are reflected on the consolidated balance sheets of the Company as investments in unconsolidated joint ventures.

Additionally, as of September 30, 2017, the Company was contingently liable for $60.9 million in letters of credit guaranteeing performance by the Company of certain obligations relating to the Centers. The Company does not believe that these letters of credit will result in a liability to the Company.

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Contractual Obligations:

The following is a schedule of contractual obligations as of September 30, 2017 for the consolidated Centers over the periods in which they are expected to be paid (in thousands):

Contractual Obligations	Payment Due by Period Total	Less than 1 year	1 - 3 years	3 - 5 years	More than five years
Long-term debt obligations (includes expected interest payments)(1)(2)	$5,750,286	$720,004	$1,273,406	$2,197,113	$1,559,763
Operating lease obligations(3)	259,527	11,560	19,253	18,363	210,351
Purchase obligations(3)	62,609	62,609	—	—	—
Other long-term liabilities	300,263	196,300	8,301	13,918	81,744
	$6,372,685	$990,473	$1,300,960	$2,229,394	$1,851,858

(1) Interest payments on floating rate debt were based on rates in effect at September 30, 2017.

(2) Long-term debt obligations to be repaid in less than one year include an aggregate of $527.7 million of mortgage loan balances on Stonewood Center, Freehold Raceway Mall and Santa Monica Place that have been subsequently paid off, refinanced or covered by a lender commitment to refinance during the fourth quarter of 2017 (See “Financing Activities” in Management’s Overview and Summary).

(3) See Note 15—Commitments and Contingencies in the Company's Notes to Consolidated Financial Statements.

Funds From Operations ("FFO")

The Company uses FFO in addition to net income to report its operating and financial results and considers FFO and FFO-diluted as supplemental measures for the real estate industry and a supplement to GAAP measures. The National Association of Real Estate Investment Trusts ("NAREIT") defines FFO as net income (loss) (computed in accordance with GAAP), excluding gains (or losses) from extraordinary items and sales of depreciated operating properties, plus real estate related depreciation and amortization, impairment write-downs of real estate and write-downs of investments in an affiliate where the write-downs have been driven by a decrease in the value of real estate held by the affiliate and after adjustments for unconsolidated joint ventures. Adjustments for unconsolidated joint ventures are calculated to reflect FFO on the same basis.

FFO and FFO on a diluted basis are useful to investors in comparing operating and financial results between periods. This is especially true since FFO excludes real estate depreciation and amortization, as the Company believes real estate values fluctuate based on market conditions rather than depreciating in value ratably on a straight-line basis over time. The Company believes that such a presentation also provides investors with a meaningful measure of its operating results in comparison to the operating results of other REITs. The Company further believes that FFO on a diluted basis is a measure investors find most useful in measuring the dilutive impact of outstanding convertible securities.

The Company believes that FFO does not represent cash flow from operations as defined by GAAP, should not be considered as an alternative to net income as defined by GAAP, and is not indicative of cash available to fund all cash flow needs. The Company also cautions that FFO, as presented, may not be comparable to similarly titled measures reported by other REITs.

Management compensates for the limitations of FFO by providing investors with financial statements prepared according to GAAP, along with this detailed discussion of FFO and a reconciliation of net income to FFO and FFO-diluted. Management believes that to further understand the Company's performance, FFO should be compared with the Company's reported net income and considered in addition to cash flows in accordance with GAAP, as presented in the Company's consolidated financial statements.

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Funds From Operations ("FFO") (Continued)

The following reconciles net income attributable to the Company to FFO and FFO-diluted for the three and nine months ended September 30, 2017 and 2016 (dollars and shares in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income attributable to the Company	$17,498	$13,730	$113,379	$479,867
Adjustments to reconcile net income attributable to the Company to FFO attributable to common stockholders and unit holders—basic and diluted:				
Noncontrolling interests in the Operating Partnership	1,256	1,272	8,351	35,067
Loss (gain) on sale or write down of assets, net—consolidated assets	11,854	19,321	(37,234)	(426,050)
Add: noncontrolling interests share of (loss) gain on sale or write down of assets—consolidated assets	—	(2,206)	—	(2,206)
Add: gain on sale of undepreciated assets—consolidated assets	727	295	727	2,932
Less: loss on write-down of non-real estate assets—consolidated assets	—	—	(10,138)	—
(Gain) loss on sale or write down of assets— unconsolidated joint ventures, net(1)	(6,712)	171	(8,981)	173
Add: gain (loss) on sale of undepreciated assets—unconsolidated joint ventures(1)	—	—	660	(2)
Depreciation and amortization—consolidated assets	83,147	86,976	249,463	259,097
Less: noncontrolling interests in depreciation and amortization—consolidated assets	(3,717)	(3,759)	(11,325)	(11,184)
Depreciation and amortization—unconsolidated joint ventures(1)	44,493	47,803	132,708	133,319
Less: depreciation on personal property	(3,499)	(3,309)	(10,326)	(9,342)
FFO attributable to common stockholders and unit holders—basic and diluted	145,047	160,294	427,284	461,671
Gain on extinguishment of debt, net—consolidated assets	—	(5,284)	—	(1,709)
FFO attributable to common stockholders and unit holders excluding extinguishment of debt, net—diluted	$145,047	$155,010	$427,284	$459,962
Weighted average number of FFO shares outstanding for:				
FFO attributable to common stockholders and unit holders—basic (2)	151,624	154,589	152,668	158,277
Adjustments for impact of dilutive securities in computing FFO-diluted:				
Share and unit based compensation plans	11	113	35	126
FFO attributable to common stockholders and unit holders—diluted (3)	151,635	154,702	152,703	158,403

(1) Unconsolidated joint ventures are presented at the Company's pro rata share.

(2) Calculated based upon basic net income as adjusted to reach basic FFO. Includes 10.3 million and 10.7 million OP Units for the three months ended September 30, 2017 and 2016, respectively, and 10.5 million and 10.8 million OP Units for the nine months ended September 30, 2017 and 2016, respectively.

(3) The computation of FFO—diluted shares outstanding includes the effect of share and unit-based compensation plans using the treasury stock method. It also assumes the conversion of MACWH, LP common and preferred units to the extent that they are dilutive to the FFO—diluted computation.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's primary market risk exposure is interest rate risk. The Company has managed and will continue to manage interest rate risk by (1) maintaining a ratio of fixed rate, long-term debt to total debt such that floating rate exposure is kept at an acceptable level, (2) reducing interest rate exposure on certain long-term floating rate debt through the use of interest rate caps and/or swaps with matching maturities where appropriate, (3) using treasury rate locks where appropriate to fix rates on anticipated debt transactions, and (4) taking advantage of favorable market conditions for long-term debt and/or equity.

The following table sets forth information as of September 30, 2017 concerning the Company's long-term debt obligations, including principal cash flows by scheduled maturity, weighted average interest rates and estimated fair value (dollars in thousands):

	Expected Maturity Date For the twelve months ended September 30,							
	2018	2019	2020	2021	2022	Thereafter	Total	Fair Va
CONSOLIDATED CENTERS:								
Long-term debt:								
Fixed rate	$577,792	$371,340	$468,317	$588,495	$361,801	$1,420,564	$3,788,309	$3,804,
Average interest rate	3.76 %	3.58 %	3.51 %	4.56 %	4.09 %	3.65 %	3.83 %	
Floating rate	—	—	200,000	1,080,000	—	—	1,280,000	1,273,2
Average interest rate	— %	— %	2.74 %	2.92 %	— %	— %	2.89 %	
Total debt—Consolidated Centers	$577,792	$371,340	$668,317	$1,668,495	$361,801	$1,420,564	$5,068,309	$5,077,
UNCONSOLIDATED JOINT VENTURE CENTERS:								
Long-term debt (at Company's pro rata share):								
Fixed rate	$28,281	$30,534	$38,296	$148,993	$48,729	$2,458,883	$2,753,716	$2,768,
Average interest rate	3.67 %	3.68 %	3.69 %	3.80 %	3.72 %	3.79 %	3.79 %	
Floating rate	337	9,305	10,126	41,993	15,000	30,000	106,761	102,711
Average interest rate	2.97 %	2.99 %	2.94 %	2.96 %	2.44 %	2.44 %	2.74 %	
Total debt—Unconsolidated Joint Venture Centers	$28,618	$39,839	$48,422	$190,986	$63,729	$2,488,883	$2,860,477	$2,871,

The consolidated Centers' total fixed rate debt at September 30, 2017 and December 31, 2016 was $3.8 billion. The average interest rate on such fixed rate debt at September 30, 2017 and December 31, 2016 was 3.83% and 3.80%, respectively. The consolidated Centers' total floating rate debt at September 30, 2017 and December 31, 2016 was $1.3 billion and $1.1 billion, respectively. The average interest rate on such floating rate debt at September 30, 2017 and December 31, 2016 was 2.89% and 2.47%, respectively.

The Company's pro rata share of the unconsolidated joint venture Centers' fixed rate debt at September 30, 2017 and December 31, 2016 was $2.8 billion and $2.7 billion, respectively. The average interest rate on such fixed rate debt at September 30, 2017 and December 31, 2016 was 3.79%, and 3.80% respectively. The Company's pro rata share of the unconsolidated joint venture Centers' floating rate debt at September 30, 2017 and December 31, 2016 was $106.8 million and $169.9 million, respectively. The average interest rate on such floating rate debt at September 30, 2017 and December 31, 2016 was 2.74% and 2.44%, respectively.

In addition, the Company has assessed the market risk for its floating rate debt and believes that a 1% increase in interest rates would decrease future earnings and cash flows by approximately $13.9 million per year based on $1.4

billion of floating rate debt outstanding at September 30, 2017.

The fair value of the Company's long-term debt is estimated based on a present value model utilizing interest rates that reflect the risks associated with long-term debt of similar risk and duration. In addition, the method of computing fair value for mortgage notes payable included a credit value adjustment based on the estimated value of the property that serves as collateral for the underlying debt (See Note 8—Mortgage Notes Payable and Note 9—Bank and Other Notes Payable in the Company's Notes to the Consolidated Financial Statements).

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Item 4. Controls and Procedures

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, management carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on their evaluation as of September 30, 2017, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is (a) recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms and (b) accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

In addition, there has been no change in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15(d)-15(f) under the Securities Exchange Act of 1934) that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

None of the Company, the Operating Partnership, the Management Companies or their respective affiliates are currently involved in any material legal proceedings, although from time-to-time they are involved in various legal proceedings that arise in the ordinary course of business.

Item 1A. Risk Factors

There have been no material changes to the risk factors relating to the Company set forth under the caption "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased		Average Price Paid per Share (1)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs		Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
July 1, 2017 to July 31, 2017	—		$ —	—		$ 318,343,926
August 1, 2017 to August 31, 2017	592,552	(2)	53.36	592,552	(2)	$ 286,725,059
September 1, 2017 to September 30, 2017	149,465	(3)	53.65	149,465	(3)	$ 278,707,048
	742,017		$ 53.42	742,017		

(1) The average price paid per share is calculated on a trade date basis.

(2) On February 12, 2017, the Company's Board of Directors authorized the repurchase of up to $500.0 million of the Company's outstanding common shares from time to time as market conditions warrant. During the period from August 1, 2017 to August 31, 2017, the Company repurchased a total of 592,552 of its common shares in a series of transactions for approximately $31.6 million, representing an average price of $53.36 per share. The Company funded the repurchases from borrowing under its line of credit.

(3) During the period from September 1, 2017 to September 30, 2017, the Company repurchased a total of 149,465 of its common shares in a series of transactions for approximately $8.0 million, representing an average price of $53.65 per share. The Company funded the repurchases from its share of the proceeds from the sale of an office building at Fashion District Philadelphia (See "Acquisitions and Dispositions" in Management's Overview and Summary) and from borrowing under its line of credit.

Item 3. Defaults Upon Senior Securities

Not Applicable

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

On November 2, 2017, in connection with a review of the compensation of the senior executive officers of the Company by the Compensation Committee (the “Compensation Committee”) of the Company’s Board of Directors, the Company’s Board of Directors, acting on the recommendation of the Compensation Committee, approved The Macerich Company Change in Control Severance Pay Plan for Senior Executives (the “Plan”). The Compensation Committee did not recommend any additional changes to the compensation of the Company’s senior executive officers at such time.

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The Plan entitles the Chief Executive Officer, President and each Senior Executive Vice President of the Company to certain benefits in the event of certain terminations of employment with the Company within 24 months following a Change in Control, unless such eligible employee is a party to an individual agreement with the Company that provides for greater payments and benefits. The discussion below describes the terms of the Plan and is qualified in its entirety by reference to the copy of the agreement, which is being filed with this Quarterly Report on Form 10-Q as Exhibit 10.1 and is incorporated herein by reference.

Pursuant to the Plan, if an eligible employee is terminated by the Company without Cause or if an eligible employee terminates his or her employment for Good Reason, in either case within 24 months following a Change in Control, such eligible employee will be entitled to receive lump sum cash payments equal to (i) annual salary and other benefits earned and accrued prior to the termination of employment, (ii) three times the sum of (A) the eligible employee's annual base salary in effect immediately prior to termination (or prior to the Change in Control, if higher) plus (B) the average of the annual incentive bonus awarded to the eligible employee in respect of the immediately preceding three years (excluding equity incentive awards granted as part of the Company's long-term equity incentive award program), (iii) a pro-rata cash bonus for the year in which the eligible employee's employment was terminated based on his or her target annual cash bonus and (iv) 36 months of COBRA continuation premiums otherwise payable by the eligible employee as of the date of termination. The eligible employee will also be entitled to (i) vested rights under any equity, compensation or benefit plan, policy, practice or program with the Company, including any acceleration of vesting of equity awards as set forth in applicable equity award agreements and (ii) outplacement services for 12 months. Receipt of these payments and benefits (other than the annual salary and other benefits earned and accrued prior to the termination of employment) is subject to execution by the eligible employee of a general release of claims with the Company.

If any payments and benefits to be paid or provided to an eligible employee, whether pursuant to the terms of the Plan or otherwise, would be subject to "golden parachute" excise taxes under the Internal Revenue Code, the payments and benefits will be reduced to the extent necessary to avoid such excise taxes, but only if such a reduction of pay or benefits would result in a greater after-tax benefit to the eligible employee.

The Compensation Committee may amend, suspend or terminate the Plan at any time prior to a Change in Control without the consent of any eligible employee; provided that any amendment, suspension or termination that reduces or otherwise adversely impairs an eligible employee's benefits under the Plan (i) will not be effective until 12 months after notice of such change is provided to the eligible employees and (ii) will not be effective if a Change in Control occurs during the 12-month notice period.

The terms Cause, Good Reason and Change in Control are specifically defined in the Plan.

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Item 6. Exhibits

Exhibit Number	Description
2.1	Master Agreement, dated November 14, 2014, by and among Pacific Premier Retail LP, MACPT LLC, Macerich PPR GP LLC, Queens JV LP, Macerich Queens JV LP, Queens JV GP LLC, 1700480 Ontario Inc. and the Company (incorporated by reference as an exhibit to the Company’s Current Report on Form 8-K, event date November 14, 2014).
3.1	Articles of Amendment and Restatement of the Company (incorporated by reference as an exhibit to the Company's Registration Statement on Form S-11, as amended (No. 33-68964)) (Filed in paper - hyperlink is not required pursuant to Rule 105 of Regulation S-T).
3.1.1	Articles Supplementary of the Company (incorporated by reference as an exhibit to the Company's Current Report on Form 8-K, event date May 30, 1995) (Filed in paper - hyperlink is not required pursuant to Rule 105 of Regulation S-T).
3.1.2	Articles Supplementary of the Company (with respect to the first paragraph) (incorporated by reference as an exhibit to the Company's 1998 Form 10-K).
3.1.3	Articles Supplementary of the Company (Series D Preferred Stock) (incorporated by reference as an exhibit to the Company's Current Report on Form 8-K, event date July 26, 2002).
3.1.4	Articles Supplementary of the Company (incorporated by reference as an exhibit to the Company's Registration Statement on Form S-3, as amended (No. 333-88718)).
3.1.5	Articles of Amendment of the Company (declassification of Board) (incorporated by reference as an exhibit to the Company's 2008 Form 10-K).
3.1.6	Articles Supplementary of the Company (incorporated by reference as an exhibit to the Company's Current Report on Form 8-K, event date February 5, 2009).
3.1.7	Articles of Amendment of the Company (increased authorized shares) (incorporated by reference as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2009).
3.1.8	Articles of Amendment of the Company (to eliminate the supermajority vote requirement to amend the charter and to clarify a reference in Article NINTH) (incorporated by reference as an exhibit to the Company’s Current Report on Form 8-K, event date May 30, 2014).
3.1.9	Articles Supplementary of the Company (election to be subject to Section 3-803 of the Maryland General Corporation Law) (incorporated by reference as an exhibit to the Company’s Current Report on Form 8-K, event date March 17, 2015).
3.1.10	Articles Supplementary of the Company (Series E Preferred Stock) (incorporated by reference as an exhibit to the Company’s Current Report on Form 8-K, event date March 18, 2015).
3.1.11	Articles Supplementary of the Company (reclassification of Series E Preferred Stock to Preferred Stock) (incorporated by reference as an exhibit to the Company’s Current Report on Form 8-K, event date May 7, 2015).
3.1.12	Articles Supplementary of the Company (repeal of election to be subject to Section 3-803 of the Maryland General Corporation Law) (incorporated by reference as an exhibit to the Company’s Current Report on Form 8-K, event date May 28, 2015).
3.2	Amended and Restated Bylaws of the Company (incorporated by reference as an exhibit to the Company's Current Report on Form 8-K, event date April 21, 2016).
10.1*	Change In Control Severance Pay Plan for Senior Executives.
31.1	Section 302 Certification of Arthur Coppola, Chief Executive Officer
31.2	Section 302 Certification of Thomas O'Hern, Chief Financial Officer
32.1**	Section 906 Certifications of Arthur Coppola and Thomas O'Hern
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document

101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

* Represents a management contract, or compensatory plan, contract or arrangement required to be filed pursuant to Regulation S-K.

** Furnished herewith.

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Signature

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

THE MACERICH COMPANY

By: /s/ THOMAS E. O'HERN

Thomas E. O'Hern

Senior Executive Vice President and Chief Financial Officer

Date: November 3, 2017 (Principal Financial Officer)

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