NETAPP
FOURTH QUARTER AND FISCAL YEAR 2021
PREPARED REMARKS
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Prepared remarks by:
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George Kurian, Chief Executive Officer
Mike Berry, EVP and Chief Financial Officer

Kris Newton: Thank you for joining us. With me today are our CEO, George Kurian, and CFO, Mike Berry. This call is being webcast live and will be available for replay on our website at netapp.com.

During today's call we will make forward-looking statements and projections with respect to our financial outlook and future prospects, such as our guidance for the first quarter and fiscal year two thousand twenty-two; our expectations regarding future revenue, profitability, and shareholder returns; and our ability to continue overall growth, gain market share, and scale our cloud business all of which involve risk and uncertainty.

We disclaim any obligation to update our forward-looking statements and projections. Actual results may differ materially for a variety of reasons, including macroeconomic and market conditions such as the continuing impact and uneven recovery of the COVID-19 pandemic; and the IT capital spending environment; as well as our ability to gain share in the storage market, grow our cloud business, and generate greater cash flow.

Please also refer to the documents we file from time to time with the SEC, and available on our website, specifically our most recent Forms 10-Q and 10-K including in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" sections.

During the call all financial measures presented will be non-GAAP unless otherwise indicated. Reconciliations of GAAP to non-GAAP estimates are posted on our website.

I'll now turn the call over to George.

George Kurian: Thanks, Kris. Good afternoon everyone. Thank you for joining us today.

Before we get started, I want to take a minute to acknowledge that it has been over a year that we have all been working remotely. I am encouraged by the public health and economic improvements in many parts of the world, but the recovery is uneven. As you know, we have a large team in India. Our thoughts are with them, as they deal with a distressing surge in Covid cases. Thank you to the entire NetApp team for your dedication, focus, and execution throughout this challenging year.

Now to the results of the quarter…

We delivered strong fourth quarter results, capping off a solid year of growth. Our results were all above our Q4 guidance ranges. I am most excited by the return of product revenue to growth, the strength of our public cloud ARR, and an all-time high free cash flow. Our performance was broad-based, as certain verticals, the U.S., and parts of Europe and Asia are recovering faster than many expected. Cloud and digital transformation initiatives have been accelerated by the pandemic and companies look to NetApp to support these key initiatives.

Going into FY21, we had two clear priorities: returning to growth in our storage business powered by share gains from our industry-leading file, block and object software and scaling our highly differentiated public cloud services business. As I reflect on the past year, I am proud of what we have achieved during a globally challenging period. We remained focused in executing our strategy and extending our innovation.

In Q4, product revenue grew 6% and our All-flash array business grew 11% year-over-year. Based on our growth, I am confident that we have gained share in the storage and All-flash markets. We advanced our hybrid cloud portfolio with the introduction of ONTAP 9.9 and Astra. This innovation will support continued product revenue growth and share gains through FY22. Additionally, we continue to make good progress with Keystone, with many new wins, including our largest ever Keystone deal.

We are reaching more customers than ever before with our public cloud business. Over the course of FY21, we added approximately 1,500 new-to-NetApp customers with public cloud services and grew our total cloud customer count by 137% from Q4 FY20. In addition to adding new cloud customers, existing cloud customers are expanding their spend with us. Our dollar-based net revenue retention rate increased to 252% in the fourth quarter. Cloud Volumes, Cloud Insights, and Spot all performed well in the quarter, driving our public cloud services ARR to $301 million exiting FY21, an increase of 171% year over year.

As we have said repeatedly, our cloud strategy strongly advantages NetApp. I'll use a customer example to illustrate how cloud helps us acquire new customers and drive growth in our on-premises solutions. As a part of its digital transformation strategy, a leading car manufacturer decided to migrate workloads from its on-premises data centers to the Azure cloud. Despite never having used NetApp previously, the customer chose NetApp Cloud Volumes to host its file-based data and NetApp Cloud Sync to rapidly move data from its Dell EMC systems to the cloud. In addition to delivering a high-performance data store in the cloud, Cloud Volumes provides out-of-the box cross region replication of production data to a secondary cloud environment, high availability to meet the service level requirements of critical applications, and cost savings through automatic tiering to Azure blob storage. Because of the breadth and depth of the value NetApp delivered, the customer is now looking to deploy a hybrid cloud environment and plans to use NetApp on-premises, as well as increase its NetApp usage in the public cloud.

As I noted earlier, the pandemic accelerated and elevated the importance of customers' cloud and digital transformation initiatives. We expect that this trend will be on-going, and that NetApp will continue to benefit from it. Customers appreciate the value we bring as a cloud-led, data-centric software company to simplify and modernize existing data centers, to quickly and confidently deploy applications, and to securely manage data on the public cloud. We have long been recognized for our industry-leading enterprise data management technology; our cloud solutions drive further differentiation, expand our addressable market, and enable us to reach new customers.

We began our cloud journey seven years ago, with the introduction of Cloud ONTAP – now, Cloud Volumes ONTAP. Our initial focus was to leverage the cloud to deliver backup and disaster recovery services to our installed base. We saw that enterprises wanted to move workloads to the cloud. To address that need, we began working with the leading cloud providers to deliver Cloud Volumes Service – a fully managed service with the application certifications required to support mission-critical, production workloads in the cloud. We then recognized the opportunity to expand beyond storage management and optimization to infrastructure monitoring and compute management and optimization services, which led to the development of Cloud Insights and the acquisition of Spot.

These services –Cloud Volumes, Cloud Insights, and Spot – are now the primary growth engines of our public cloud services business. They are well established for enterprise applications, and we are taking each of them into the cloud native world, further expanding our market opportunity. NetApp Astra offers application-aware data management that protects, moves, and manages data-rich Kubernetes workloads. Spot Ocean automates cloud infrastructure for containers, automatically scaling compute resources to maximize utilization and availability while minimizing costs. Cloud Insights for Kubernetes provides simplified infrastructure monitoring to quickly identify performance issues and resource constraints. Together, our public cloud services give our customers, and especially their CloudOps and DevOps teams, a robust suite of multi-cloud infrastructure management services.

We plan to press our advantage here by focusing our efforts on enhancing our go-to-market activities, deepening our cloud partnerships, and delivering best-in-class organic and inorganic innovations. We intend to leverage our deep infrastructure expertise and our credibility with the cloud providers to expand our multi-cloud infrastructure management services. My confidence in our ability to reach our goal of $1 billion in public cloud ARR in FY25 is further enhanced by the strength and uniqueness of our cloud services position.

Our focused execution last year has set us up well for FY22. We have returned to growth, we are gaining share in key storage markets, and our public cloud services are at a scale where they are positively impacting total company billings and revenue growth. Our momentum underscores our value to customers in a hybrid, multi-cloud world. In FY22, we plan to accelerate our public cloud services and continue to grow our hybrid cloud business. I am excited about the year ahead and confident in our ability to deliver top line growth by supporting our customers on their cloud and digital transformation journeys.

Before I turn it over to Mike to walk through our financial results, I want to take a moment to thank Brad Anderson, who let us know that he intends to retire at the end of FY22. Brad has been instrumental in leading the maturation of our hybrid cloud group and we will continue to leverage his leadership and expertise this year. We are actively engaged in identifying his successor to ensure a smooth transition.

With that, I'll turn it over to Mike.

Mike Berry: Thank you George. Good afternoon everyone and thank you for joining us. As a reminder, I'll be referring to non-GAAP numbers unless otherwise noted.

As we look back on what was an unprecedented year, I cannot help but be incredibly proud of the focus, execution, and commitment of the entire NetApp team. We delivered billings of $5.9 billion dollars, an increase of 9% year-over-year, while revenue of $5.7 billion dollars grew 6%. We delivered free cash flow of $1.2 billion, up 25% year-over-year, while continuing to aggressively invest in our public cloud franchise.

We finished the year strong, with Q4 billings of $1.7 billion dollars, up 12% year-over-year, while revenue of $1.6 billion was up 11% year-over-year. Both were solidly ahead of our expectations, driven by accelerating enterprise demand throughout the quarter. Gross margin, operating margin and EPS all came in above the high-end of guidance. Q4 free cash flow of $521 million was an all-time high for NetApp.

As George highlighted, public cloud ARR of $301 million was up 171% year-over-year and an impressive 27% sequentially. In Fiscal 21, the scale of our cloud franchise really started to impact the overall growth profile of NetApp—delivering 4 of the 9 points in billings growth and 3 of the 6 points in revenue growth. In addition to the strong cloud ARR performance, we are excited that we exited the year with cloud gross margins near our overall corporate average. Given the growing impact on our total company performance, we anticipate sharing more detail on our public cloud business in Fiscal 22.

When combined, software revenue, recurring support and cloud revenue totaled $1.1 billion dollars and increased 18% year-over-year, representing 72% of total revenue. For the first time in company history, we ended Q4 with over $4 billion dollars in deferred revenue, an increase of 8% year-over-year. Deferred revenue continues to be a leading indicator for future recurring revenue growth.

Product revenue returned to growth in Q4—importantly, we expect this trend to continue throughout Fiscal 22. Product revenue of $840 million dollars increased 6% year-over-year. Consistent with the trends we have seen throughout Fiscal 21, software product revenue of $480 million dollars increased 18% year-over-year, driven by the continued mix shift towards our All-flash portfolio.

Recurring support and cloud revenue of $641 million was also an all-time company high and was up 17% year-over-year, constituting 41% of total revenue.

Gross margin of 67.3% was at the high-end of guidance. Product gross margin was 54.3% and benefited from higher All-flash system mix. Our recurring support, cloud and other services business continues to be a very profitable and growing business for us, with gross margin of 82%.

Operating margin of 23% was nicely ahead of our expectations, while EPS of $1.17 came in above the high-end of guidance—despite a $0.05 headwind from a higher than forecasted tax-rate.

Cash flow from operations was $559 million dollars and free cash flow was $521 million dollars, representing 34% of revenue. Cash flow came in higher than expected in part due to strong collections, as evidenced by the DSO metric of 55 days. Full-year Fiscal 21 free cash flow of $1.2 billion was up 25% year-over-year and represented 20% of revenue. We closed Q4 with $4.6 billion dollars in cash and short-term investments.

Given recent developments in the broader technology supply chain, I want to reiterate our confidence in our ability to meet end-demand as we head into Q1. We have an excellent supply chain team and they have been working closely with our partner ecosystem to ensure backlog and customer lead-times remain at normal levels throughout Fiscal 22. Towards this goal, we will be investing incremental dollars into inventory and longer-term commitments to help mitigate risk of supply shortages. Given our strong balance sheet and low-cost of capital, we feel good about this investment.

Now to guidance.

In Fiscal 22, we expect revenues to grow 6 to 7% year-over-year, with billings expected to outpace revenue given the continued strength in recurring support contracts and cloud services. In Fiscal 22, we expect continued momentum and share gains in our cloud-connected All-flash portfolio. We will also continue to grow and invest in our diversified public cloud services portfolio. We are raising the low-end our Fiscal 22 guide and now expect to exit Fiscal 22 with public cloud ARR of $425 to $500 million, driven by enhanced go-to-market activities, deeper cloud partnerships and continued product innovation. Similar to the seasonal pattern we experienced in Fiscal 21, we anticipate Q2 and Q4 to be our strongest quarters for net new public cloud ARR—this seasonal cadence is driven by our semi-annual sales compensation plans. As George noted, we have increased confidence in our ability to eclipse $1 billion in public cloud ARR in Fiscal 25.

In Fiscal 22, we expect gross margin to be roughly flat year-over-year at 67 to 68%, as improving cloud margins are balanced with strong demand for our hybrid cloud products. We anticipate operating margin to range between 21 to 22%, as we continue to invest in our growth initiatives, while delivering strong operating leverage. Implied in this guidance is our expectation that operating expenses will be $2.75 to $2.80 billion. The year-over-year increase in our expense base is being driven by continued investment in revenue generating activities, including expanding our cloud portfolio, targeted investments in sales resources and continued investment in our customer success sales team.

Moving down the P&L, we expect interest expense to be $65 to $70 million and our effective tax-rate to be approximately 19%. While we get a bit of de-levering below the operating income line, as a result of the higher interest expense and tax-rate, we are committed to delivering $4.45 to $4.65 in Fiscal 22 EPS—representing 12% year-over-year growth, at the mid-point.

We expect to again generate over $1.1 billion in free cash flow in Fiscal 22, as our hybrid cloud business continues to fund the growth in our cloud services franchise. Factored into the year-over-year free cash flow generation is a step-up in capex to $225 to $235 million. Our public cloud partners, in particular Azure, are driving us hard to build out additional global capacity for our cloud offerings. Even with this added investment, we expect Cloud gross margins to become accretive to our corporate average as we move through Fiscal 22.

Generating over $1.1 billion in free cash will allow us to continue to deliver on our capital allocation commitments, while also investing in our key strategic areas. The dividend will remain the first call on capital—as you saw today, we raised our quarterly dividend to $0.50 per share. Share repurchases will also continue to play a key role in our capital allocation strategy— towards this goal our Board approved an additional $500 million in buyback authorization. In Fiscal 22, we expect buybacks to offset dilution from our equity plans. For modeling purposes, we expect share count to remain flat at 229 million shares exiting Fiscal 22. Consistent with NetApp's long history of disciplined M&A, the remaining 30% of free cash generation will go towards our acquisition strategy, which will remain focused on bolstering our strategic Cloud Services roadmap.

Now on to Q1 guidance.

We expect Q1 net revenues to range between $1.37 billion dollars and $1.47 billion dollars which, at the midpoint, implies a 9% increase in revenues year-over-year. We expect consolidated gross margin to be approximately 68% and operating margin to range between 19 and 20%. Assumed in this guidance are Q1 operating expenses of $680 to $690 million dollars. We anticipate our tax-rate to be approximately 19%. And we expect earnings per share for Q1 to range between $0.89 and $0.97 per share. Assumed in our Q1 guidance is interest expense of $15 to $20 million dollars.

In closing, I want to thank our partners, customers and investors for their unwavering support this past year. And most importantly, a huge shout out to the entire NetApp employee base for redefining what it means to work as a team, during what was a challenging year in so many ways. We are more confident than ever in our ability to capitalize on the industry transitions and market opportunity ahead.

I'll now hand it back to Kris to open the call for Q&A. Kris?

Kris Newton: Thanks Mike. Let's open the call for Q&A. Please keep to just one question so we can get to as many people as possible. Operator?