



**NETAPP
THIRD QUARTER OF FISCAL YEAR 2022
PREPARED REMARKS
FEBRUARY 23, 2022**

Kris: 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 fourth quarter and fiscal year two thousand twenty-two; our expectations regarding future revenue, profitability, and shareholder returns; the value we bring to customers; our ability to drive continued growth in both our Hybrid Cloud and Public Cloud segments; and our ability to manage through the current supply chain environment; 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, including the resulting supply chain disruptions; 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: Thanks, Kris. Good afternoon and welcome everyone to our Q3 FY22 earnings call.

We delivered another outstanding quarter, building on the momentum we've had in recent periods. Demand for our solutions is strong and powered by the alignment of our differentiated technology portfolio with customer priorities.

In Q3, our focused execution delivered:

- Double-digit revenue growth, led by the impressive performance of our Public Cloud Services and All-flash array businesses.
- Record high gross margin dollars, operating income, and earnings per share.

NetApp plays a critical role in helping customers achieve their business and cloud transformation goals. I am pleased that our differentiation here continues to receive third-party validation by industry leaders, independent analysts, and existing and new customers.

We were recognized by Amazon Web Services for our achievements as an AWS partner. NetApp was named the 2021 AWS Independent Software Vendor Design Partner of the Year - US, for the jointly engineered and natively integrated Amazon FSx for NetApp ONTAP service.

Additionally, GigaOm called out NetApp as the only vendor with a multi-cloud strategy and execution that translates to a continuous data management plane across clouds and locations, a comprehensive enterprise-grade feature set, and flexible deployment options. We were listed as a leader in three GigaOm Radar reports: Cloud File Systems, Primary Storage for Large Enterprises, and Enterprise Scale-Out File Systems. Not only are we a leader in each category, we are the only vendor to lead in all three. This recognition spotlights the value we bring to our customers on their cloud and digital transformation journeys.

Customers are also endorsing our value, creating strong demand for solutions in both our Hybrid Cloud and Public Cloud segments.

Growth in our Hybrid Cloud segment was driven by continued strength in object storage and All-flash arrays. Our All-flash array business hit another milestone in Q3, with a record high annualized run rate of \$3.2 billion, an increase of 23% year over year. All-flash array penetration of our installed base ticked up another point to 31% of installed base systems, giving us substantial headroom to continue to help existing and new customers modernize their storage environments with cloud-connected flash arrays. We further enhanced our position with the introduction of the AFF A900, which delivers unified support for file, block, and object protocols, built-in data protection with cutting-edge anti-ransomware capabilities, and the high performance and resiliency required to support the most critical business workloads.

Public Cloud ARR grew to \$469 million, an increase of 98% year over year, including the benefit from the Cloud Checkr acquisition which closed early in Q3. Public Cloud dollar-based net revenue retention rate remains healthy at 169%, as customers increase their usage of our public cloud services and adopt new products. The expanded market reach from our cloud partners and the broadening participation of our field sales organization has delivered outstanding performance in our Public Cloud segment this year, which puts us well ahead of our plan to achieve \$1 billion in ARR in FY '25.

We, uniquely, have fully integrated services with all the major public cloud providers. I am pleased with the level of engagement from our cloud partners and with the performance of our Cloud Storage services. Azure NetApp Files again grew ahead of plan; Cloud Volumes Service for Google Cloud is ramping nicely; and, while still very early days, we are seeing lots of proofs of concept and activity with AWS FSx for NetApp ONTAP.

Our differentiated CloudOps portfolio for multi-cloud infrastructure management is also growing well, led by Spot and Cloud Insights. It is expanding our addressable market, and opening opportunities with new buyers at existing customers and with new customers, as we help them reduce the cost and complexity of managing their rapidly growing cloud environments.

We are delivering innovation at cloud speed and enhancing our solutions to address the needs of cloud natives and born-in-the-cloud applications. We've made Cloud Backup Kubernetes aware and broadened Spot Ocean with automated cloud infrastructure and application management for Apache Spark and Ocean CD, enabling faster deployment of Kubernetes applications with end-to-end visibility and management.

As I mentioned earlier, we closed the CloudCheckr acquisition early in Q3. CloudCheckr complements the FinOps capability of Spot with the multi-cloud reports, analytics and governance needed to plan, manage, and optimize cloud costs to ensure organizations get the most out of their cloud investment.

We continue the rapid pace of organic and inorganic innovation with today's announcement of the acquisition of Fylamynt. Fylamynt extends our leadership in cloud operations. Adding Fylamynt's cloud automation technology to the Spot platform will make it easy for customers to integrate Spot's solutions with their existing tools, processes, and infrastructure code. This will accelerate their ability to take advantage of Spot's suite of capabilities for understanding and optimizing their cloud infrastructure. I am excited to welcome the Fylamynt team to NetApp.

As I've said many times, our strategy to help customers deal with the challenges of managing data and applications in hybrid, multi-cloud environments is helping us expand our business by winning new customers and displacing the competition.

A global third-party logistics company chose FSx for NetApp ONTAP to host data migrated from Nutanix systems in its data centers. They chose NetApp-based cloud services for our resiliency, cost-efficiency, and multi-protocol support. This win marks a new logo for us and has already created additional opportunity for Cloud Manager and Cloud Insights.

Another new customer win came from a multinational energy infrastructure company who chose Cloud Volumes ONTAP in Azure to migrate workloads away from on-premises Dell systems. They

are now considering replacing expired Dell systems with on-premises NetApp systems to make it easier to move data across environments in the future.

We had a first time win at an international government agency with Spot Eco to optimize its multi-million dollar cloud spend. This win becomes a lighthouse reference account for us, which we can leverage to reach into other, related agencies.

In summary, our strong Q3 results underscore our unique position in solving organizations' most significant challenges in both cloud-native and traditional applications, on-premises, and in hybrid, multi-cloud environments. First, we help customers simplify and modernize existing data centers and deploy traditional applications quickly and confidently. Second, we help customers adopt modern application architectures, like Kubernetes and microservices, for new workloads and deploy data-rich applications like machine and deep learning. And, third, we help customers optimize cost, performance, availability, and security for applications and associated infrastructure across multiple clouds.

The complexities created by rapid data growth, multi-cloud management, and the adoption of next-gen technologies create a sizeable opportunity for us. With focused execution, I am confident in our ability to capture that opportunity and deliver continued growth. We're holding an Investor Day on March 22nd where we'll talk more about our growth opportunity and our plans to drive shareholder value. You can register at investors.netapp.com. If you have any questions, please reach out to the IR team.

Before I turn the call over to Mike to walk you through the numbers, I want to take a moment to welcome Harv Bhela to NetApp as our Chief Product Officer. Harv brings with him more than 25 years of experience building industry-defining software categories and cloud services. I also want to thank Brad Anderson for his leadership and wish him well in his retirement.

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

Mike: 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.

Before we go through the financial details, I think it would be valuable to walk you through the key themes for today's discussion:

- 1) Q3 was another strong quarter, with all-time company highs in gross profit dollars, operating income and EPS, as our business model continues to show significant operating leverage as we grow our operating profitability and margins;
- 2) Our Cloud business had another outstanding quarter—we clearly are solidly ahead of our original plan to hit our \$1B ARR target in Fiscal '25;
- 3) We are prioritizing meeting as much customer demand as possible as we navigate near-term component shortages, and expect revenue to continue to be constrained in Q4; and
- 4) We are increasing our full year guidance for revenue, EPS and Public Cloud ARR, driven by the outperformance in Q3 and a very healthy demand backdrop for Q4.

Now to the details. In Fiscal Q3 we delivered strong revenue, gross margin, and operating leverage across the entire business. Outstanding execution by the NetApp team yielded Q3 billings of \$1.76 billion, up 10% year-over-year. Revenue came in at \$1.61 billion, also up 10% year-over-year. Our solid Q3 results were driven by continued strong demand across both our Hybrid Cloud and Public Cloud segments.

Hybrid Cloud segment revenue of \$1.5 billion was up 6% year-over-year. Within Hybrid Cloud, we delivered product revenue growth for the fourth consecutive quarter and expect this momentum to continue into Q4 and throughout Fiscal '23. Product revenue of \$846 million increased 9% year-over-year. Consistent with the trends we've seen over the last two years, software product revenue of \$507 million increased 18% year-over-year, driven by the on-going mix shift towards our All-flash portfolio.

Total Q3 recurring support revenue of \$586 million increased 3% year-over-year.

As George highlighted, our All-flash revenue run rate, which includes both product and support revenue, eclipsed \$3.2 billion for the first time in the company's history and was up 23% year-over-year.

Public Cloud ARR exited Q3 at \$469 million, up 98% year-over-year and 21% sequentially, driven by strong growth in Azure NetApp Files, Spot and Cloud Insights—with Cloud Checkr contributing \$35 million in ARR. Organic Public Cloud ARR—excluding Cloud Checkr—was \$434 million in Q3, up 83% year-over-year. Public Cloud revenue recognized in the quarter was \$110 million, up 100% year-over-year and 26% sequentially. The growing scale of our Public Cloud portfolio continues to positively impact the overall growth profile of NetApp—delivering 4 of the 10 points in revenue growth.

Recurring support and Public Cloud revenue of \$696 million was up 11% year-over-year, constituting 43% of total revenue.

When combined, software product revenue, recurring support and Public Cloud revenue totaled \$1.2 billion—another company high—and increased 14% year-over-year, representing 75% of total revenue, up from 72% in Q3 '21.

We ended Q3 with \$4 billion in deferred revenue, an increase of 4% year-over-year. Q3 marks the 16th consecutive quarter of year-over-year deferred revenue growth, which is the best leading indicator for continued recurring revenue growth.

Total gross margin was 67%, reflecting the value of our software and Public Cloud portfolio. Total Hybrid Cloud gross margin was also 67% in Q3. Within our Hybrid Cloud segment, product gross margin was 52%, while our growing recurring support business continues to be very profitable, with gross margin of 92%.

Public Cloud gross margin of 71% was accretive to the overall corporate average. As we highlighted last quarter, we expect Public Cloud gross margins to continue to trend towards our long-term goal of 75% to 80%, as an increasing percentage of our Public Cloud business will be built on software solutions. The introduction of FSx for ONTAP with AWS, and the addition of Cloud Checkr to the Spot portfolio, both of which are software offerings, support our long-term margin goal.

Q3 highlighted the tremendous leverage in our operating model, with operating margin of 25%—**an all-time company high**. EPS of \$1.44 was up 31% year-over-year and also represented a new quarterly record for the company.

Cash flow from operations was \$260 million and free cash flow was \$199 million. During Q3 we repurchased \$125 million in stock and paid out \$111 million in cash dividends. In total we returned \$236 million to shareholders, representing 119% of free cash flow. We closed Q3 with \$4.2 billion in cash and short-term investments.

As many companies have highlighted during this earnings season, the dynamic supply chain situation continues to cause disruptions across the technology ecosystem—these headwinds were further exacerbated by Omicron. In addition to a worsening freight and expedite environment, we also experienced component supplier decommits beginning in the second half of Q3, which required us to purchase components in the open market at significant premiums. We were faced with the short-term decision of supporting the robust customer demand versus optimizing near-term product margin. NetApp has consistently focused on being a great long-term strategic partner to our loyal customer base, especially throughout the last two years of Covid. Consistent with this philosophy, we made the strategic decision to prioritize meeting customer demand, with the tradeoff being lower product margins in the short-term. To be clear, the pricing and availability of our core HDD and SSD components are stable and are not a contributor to the near-term headwinds.

With these supply chain headwinds as a backdrop, I want to highlight two critical takeaways: 1) we believe these cost headwinds are temporary in nature; and 2) we expect that Q4 will be the trough

for product margins. As you all know, the timing of getting completely through these supply chain challenges remains fluid, but we do expect cost improvements in the coming quarters as the supply headwinds begin to ease throughout the first half of Fiscal '23. We also expect our recent price increases to help further stabilize product margins in the coming quarters. As the supply base for components and airline cargo normalize, we are confident that product margin will return to its structural level in the mid-50s—particularly as our mix continues to trend towards All-flash.

We do anticipate these supply chain challenges to impact our product revenue and product gross margins in Q4—the supply chain headwinds, and our ongoing actions to mitigate them, have been factored into our Q4 and updated full year guidance.

We expect Q4 net revenues to range between \$1.635 and \$1.735 billion which, at the midpoint, implies an 8% increase year-over-year. We anticipate consolidated gross margin in Q4 to be approximately 64%—the near-term margin headwind is being driven by an incremental \$50 to \$60 million of premiums we expect to incur in open market component purchases. Consistent with our philosophy and culture, we actively prioritized being a great strategic partner to our loyal customers, many of which have been with us for over 25 years; and feel great about the discipline and execution the NetApp team has displayed in managing through the current supply situation. We expect operating margin to be approximately 22% in Q4, which would have been closer to 25% without the recent supplier decommits. Assumed in this guidance are Q4 operating expenses of \$705 to \$715 million, driven by continued investment in revenue generating activities, including expanding our Public Cloud portfolio, and investments in both our Cloud and customer success sales teams. We anticipate earnings per share for Q4 to range between \$1.21 and \$1.31 per share. Assumed in our Q4 guidance is our expectation that other income and expense will be a negative \$15 million and our tax-rate will be approximately 18%.

Our Q4 guidance implies revenue growth of approximately 10% year-over-year for Fiscal '22. We also have growing confidence in our expanding Public Cloud opportunity, driven by enhanced go-to-market activities, deeper and broader cloud partnerships and continued product innovation. As a

result, we are raising the guidance on our Public Cloud ARR, with a new range of \$525 to \$545 million exiting Fiscal '22. Please note that Fylamynt is a tech and talent acquisition and will not contribute any ARR in Q4.

The implied forecast for total gross margin is approximately 67% for the full year. Our disciplined management of the business, despite the backdrop of supply cost headwinds, has allowed us to reaffirm our full-year operating margin guidance of 23% to 24%.

We are raising our Fiscal '22 EPS guidance. We now expect EPS to range between \$5.07 and \$5.17—representing 26% year-over-year growth, at the mid-point.

In closing, I want to thank the entire NetApp team for the outstanding execution in delivering strong Q3 results. We will continue to be disciplined and long-term minded as we manage through the temporary supply challenges to meet as much customer demand as possible. Given the current environment, George and I are incredibly proud that the team stayed focused on our strategic priorities and have collectively leaned into executing against the tremendous growth opportunity we see over the next 3 to 5 years. As George mentioned, we plan to host an Investor Day on March 22nd where we will further discuss the long-term growth potential and value drivers for our shareholders, customers and partners.

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

Kris: Thanks Mike. Let's open the call for questions. Operator, let's begin the Q & A.