



**NETAPP**  
**FOURTH QUARTER AND FISCAL YEAR 2022**  
**PREPARED REMARKS**  
**June 1, 2022**

Prepared remarks by:  
Kris Newton, VP, Investor Relations  
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](http://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 first quarter and fiscal year two thousand twenty-three; 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 Kurian:** Thank you, Kris. Thanks everyone for joining us this afternoon.

Our solid fourth quarter results cap off a strong year. We made sustained progress against our strategic goals, successfully achieving our commitment to grow the business while delivering operating leverage in fiscal 2022. We gained share in enterprise storage with strong growth in All-flash array and object storage products. We expanded our Public Cloud business with robust expansion of customers, ARR, innovation, and routes to market. And, most notably, we delivered record levels of gross margin dollars, operating income, and earnings per share.

While the demand environment remains strong, macroeconomic uncertainty, including supply constraints, rising interest rates, inflation, and geopolitical conflict, has increased since we last spoke with you at our Investor Day in March. Navigating this complex and dynamic environment is testing our teams, and we are sharply focused on managing what is in our control. Backlog is elevated due to supply constraints, despite our excellent supply chain management helping us meet as much of the demand as possible. I want to thank our global team for their disciplined execution and agile response to changing conditions. That we achieved all-time highs for gross margin dollars, operating income, and earnings per share in the face of these headwinds demonstrates our disciplined operating management.

The turbulent environment also creates challenges for our customers, raising the urgency for data-driven digital and cloud transformations. We sit at the intersection of these megatrends, as the complexities created by rapid data growth, multicloud management, and the adoption of next-gen technologies such as AI, cloud native, and modern application and data infrastructures create a sizeable opportunity for us. At our Investor Day, we outlined our objective to deliver long-term value through sustained growth and that thesis remains unchanged. Our critical role in helping customers achieve their transformation goals underpins our strategy and drives confidence for future growth.

Public Cloud ARR of \$505 million grew 68% year over year and the Q4 dollar-based net revenue retention rate remains strong at 159%.

Before I get to the many highlights of the quarter, I want to address the fact that our Public Cloud ARR came short of our expectations. Demand for our cloud storage solutions was strong in Q4. We also saw a healthy number of new customer additions across both cloud storage and cloud operations services in the quarter. Unfortunately, these tailwinds were not enough to offset the lower-than-expected growth created by higher churn, lower expansion rates, and salesforce turnover in our cloud operations portfolio.

We understand the root causes of these temporary headwinds, and, in FY'23, our focus will be on returning these services to the growth trajectory we saw in the first three quarters of the year. We have made organizational changes to increase focus on renewal and expansion motions and will continue to refine our go-to-market activities to better address the cloud operations market. Additionally, we have refreshed the sales organization and strengthened the leadership team.

We believe strongly in the sizable opportunity created by our cloud operations portfolio, where we bring differentiated enterprise capabilities to cloud infrastructure management, built on our long experience supporting a broad range of applications. Our differentiation in this space continues to receive third-party validation – Spot by NetApp was recognized as a leader and the only outperformer in GigaOm's Radar for Cloud Resource Optimization.

As I noted earlier, our cloud storage services continue to perform well. Azure NetApp Files remains the standout here. Cloud Volumes Service for GCP and FSx for NetApp ONTAP also had strong growth in ARR and customer additions, albeit off small bases.

We continue to deliver significant innovation to help customers get the most from their cloud storage environments. AWS announced FSx for ONTAP support for single availability zones, lowering storage costs and improving performance, as well as its inclusion in the EC2 launch wizard, streamlining the selection of FSx for ONTAP as file storage for customers creating a new compute instance. These new capabilities unlock new use cases, expanding the opportunity for FSx for ONTAP.

Our cloud storage and data management services are complemented by our cloud operations infrastructure management and optimization functionality. Together, these capabilities deliver an industry-leading portfolio of multicloud infrastructure services for stateful and stateless workloads. Now we're enabling customers to deploy applications quickly, easily, and cost-effectively on that multi-cloud infrastructure – for big data applications with Spark on Kubernetes, for managed desktops with Spot PC, and for open-source database, data pipeline and workflow applications with our most recent acquisition, Instacluster.

Instacluster delivers open-source data and workflow applications as a fully managed service. Instacluster will leverage our best-in-class infrastructure services – Cloud Volumes' storage optimization, Spot's compute optimization, and Cloud Insight's monitoring and troubleshooting – to make it easier and faster for customers to build, deploy and operate cloud applications. This will enable us to deliver more value to cloud operations teams and capture more revenue from those same buyers by delivering new services, as well as through the significant synergies with our cloud storage services. I am excited to welcome the Instacluster team to the NetApp family.

Overall, FY22 was a good year for our cloud business. We doubled Public Cloud segment revenue from \$199 million in FY2021 to \$396 million in FY'22; we expanded our cloud partnerships and routes to market; introduced new, organic innovations; and we completed a number of acquisitions that position us well for the future. In the coming year, we will prioritize the integration of these services. To underscore our commitment here, we plan to slow the pace of acquisitions and reprioritize our use of cash in FY'23 to favor shareholder returns. Mike will provide the details in his commentary. I want to underscore that we remain convinced of the opportunity, the strength of our position and our ability to achieve \$2 billion in ARR exiting FY'26.

### Now turning to Hybrid Cloud

Demand for our Hybrid Cloud solutions remains high. Despite supply constraints that again impeded our ability to meet all customer demand, we grew product revenue 6% in the fourth quarter and 10% in FY'22. All flash array annualized revenue run rate grew 12% year over year to \$3.2 billion. Thanks to strong unit growth in FAS hybrid arrays, all flash penetration remained flat at 31% of installed systems.

In Q4 we further enhanced our position in hybrid cloud with new innovations and recognition. We updated our object storage solution with security and compliance enhancements, Google Cloud integration, and faster performance for analytics workloads. We also announced the next generation of our collaboration with Cisco, FlexPod XCS for hybrid, multichord deployments. Additionally, Business Intelligence Group recognized NetApp AI as a winner of its Artificial Intelligence Excellence Award.

Looking forward, our priorities are clear. We remain focused on capturing the substantial opportunity ahead as we scale our Public Cloud services while continuing to drive growth in our Hybrid Cloud solutions. The long-term thesis we presented at our Investor Day of delivering value through sustained growth remains intact. The strong fundamentals of our business, including our alignment to customer priorities, strong balance sheet, and prudent operational management put NetApp in a position of strength. I want to underscore my confidence in our strategy, our execution, and the value we bring to all our stakeholders.

With that, I'll turn the call 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 Fiscal '22, I am incredibly proud of the results the team delivered in an environment with such fluid and complex supply chain challenges. We delivered billings of \$6.7

billion, an increase of 13% year-over-year, and grew revenue 10% to \$6.3 billion. Within our Hybrid Cloud segment, All-flash revenue grew 20% and object storage revenue grew 49%. We finished Fiscal '22 with \$505 million in Public Cloud ARR, with Public Cloud revenue growing 99% for the full year. We balanced strong growth in our key strategic areas with another year of disciplined investment—delivering record operating margin of 23.7% (up more than 3-points from last year), with all-time high EPS of \$5.28, up 30% year-over-year.

In Q4, despite supply-constrained shipments, elevated freight and logistical expense, and component cost headwinds, we delivered solid revenue, with both gross margin and operating margin coming in above guidance. Strong execution yielded Q4 billings of \$2.0 billion, up 16% year-over-year. Revenue came in at \$1.68 billion, up 8% year-over-year, including a 2-point headwind from Fx. Our solid Q4 results were driven by continued strong demand for our All-flash and object storage solutions. Our Cloud portfolio continues to positively impact the overall growth profile of NetApp—delivering 3 and a half of the 8 points in revenue growth.

Hybrid Cloud segment revenue of \$1.56 billion was up 5% year-over-year. Within Hybrid Cloud, we delivered product revenue growth for the fifth consecutive quarter and expect this momentum to continue into Fiscal '23. Product revenue of \$894 million increased 6% year-over-year. Software product revenue of \$530 million increased 10% year-over-year, driven by the on-going mix shift towards our All-flash portfolio. Total Q4 recurring support revenue of \$590 million increased 2% year-over-year, highlighting the health of our installed base.

Public Cloud ARR exited Q4 at \$505 million, up 68% year-over-year, driven by strength in Cloud Storage, led by Azure NetApp Files. Public Cloud revenue recognized in the quarter was \$120 million, up 82% year-over-year and 9% sequentially. We didn't end the year as expected for Cloud ARR, but are confident that we remain well-positioned to deliver on the long-term Public Cloud opportunity. While it is not unusual for hypergrowth assets to hit air pockets along their journey, we are using this moment to learn, and continue to improve the operational rigor across the CloudOps products. Towards this goal, we are laser focused on using Fiscal '23 to strengthen our field and customer success motion, while integrating our CloudOps product portfolio.

Recurring support and Public Cloud revenue of \$710 million was up 11% year-over-year, constituting 42% of total revenue.

We ended Q4 with a record \$4.2 billion in deferred revenue, an increase of 6% year-over-year. Q4 marks the 17<sup>th</sup> consecutive quarter of year-over-year deferred revenue growth, which is the best leading indicator for recurring revenue growth. Total gross margin was 66% and came in solidly ahead of our guidance, reflecting better than expected product margins. Total Hybrid Cloud gross

margin was 65% in Q4. Within our Hybrid Cloud segment, product gross margin was 51%, as the supply chain team did an amazing job of mitigating a portion of the component cost headwinds, and our sales team was very focused on capturing our recent price increases. Our growing recurring support business continues to be very profitable, with gross margin of 93%.

Public Cloud gross margin of 68% was again accretive to the overall corporate average. The sequential decline in Public Cloud gross margin was driven by lower than expected Cloud revenue and incremental CapEx investment for Azure NetApp Files, which is a healthy leading demand signal. We remain confident in our long-term Public Cloud gross margin goal of 75 to 80%, as we continue to drive scale in cloud storage and an increasing percentage of our Public Cloud business being built on software solutions.

Q4 highlighted the strong leverage in our operating model, with operating margin of 23%, despite the ongoing supply chain headwinds. EPS of \$1.42 was up 21% year-over-year, and even excluding a one-time tax-benefit of \$0.12, represents a new Q4 record for the company.

Cash flow from operations was \$411 million and Free Cash Flow was \$343 million. The ongoing supply constraints resulted in shipments being pushed to the end of the quarter, leading to the highest ever accounts receivable balance of \$1.2 billion exiting the year—an increase of \$431 million from Q3. As a result, we expect healthy cash collections in the first half of Fiscal '23, which will be a tailwind to operating cash flow for the full year. During Q4 we repurchased \$250 million in stock and paid out \$111 million in cash dividends. In total we returned \$361 million to shareholders, representing 105% of Free Cash Flow. We closed Q4 with \$4.1 billion in cash and short-term investments.

### Now to guidance

In Fiscal '23, we are guiding revenues to grow 6 to 8% year-over-year, which includes a 2 percentage point headwind from Fx. In Fiscal '23, we anticipate sustained demand for and continued share gain momentum in both our All-flash and object storage solutions, which we expect to drive product revenue growth in the mid-single digits. We will also continue to grow and invest in our Public Cloud business. We expect to exit Fiscal '23 with Public Cloud ARR of \$780 to \$820 million, which includes approximately \$40 million from our recently closed acquisition of Instacluster. At the ARR mid-point, we expect our Public Cloud segment to drive 4-points of total company revenue growth in Fiscal '23. As George noted, we remain confident in our ability to deliver \$2 billion in Public Cloud ARR exiting Fiscal '26.

In Fiscal '23, we expect gross margin to range between 66 and 67%, as elevated component costs and logistical expenses from supply constraints continue to weigh on product margins. We expect

first half product margins to be roughly consistent with Q4 levels. As we previously disclosed, we believe these cost headwinds are temporary in nature; and we believe that Q4 '22 is 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, coupled with our recent price increases, to be a modest tailwind to product margins as we head into the back-half of Fiscal '23. We anticipate operating margin to range between 23 and 24% for the full year, as we continue to invest in our growth initiatives, while maintaining a disciplined approach to spending. Our commitment is to again grow revenue faster than operating expenses in Fiscal '23.

Moving down the P&L, we expect net interest expense to be approximately \$30 million and our effective tax-rate to be in the range of 21 to 22%. Despite the considerable headwind to earnings as a result of the higher tax-rate, we are committed to delivering \$5.40 to \$5.60 in Fiscal '23 EPS.

We expect to generate greater than \$1.4 billion in operating cash flow in Fiscal '23, as we continue to drive incremental profitability in our hybrid cloud segment to fund the growth in our Public Cloud business. Free Cash Flow is expected to exceed \$1.1 billion for the full year. Factored into the year-on-year Free Cash Flow growth is a step-up in CapEx to approximately \$250 to \$300 million. The higher CapEx forecast is being driven by 3 key items: (1) additional capacity deployments in Azure and GCP; (2) higher Cloud software capitalization; and (3) growing pipeline for our Keystone offering. As we've discussed before, additional capacity deployments within Azure and GCP are a healthy leading indicator for Cloud Storage demand.

Generating over \$1.1 billion in Free Cash Flow will allow us to continue to deliver on our shareholder return commitments, while also investing in our key strategic areas. From a capital allocation perspective, we expect to hit pause on CloudOps acquisitions for the first half of Fiscal '23, as we focus on strengthening our field and customer success go-to-market motions, while integrating our CloudOps product portfolio. As a result, we plan to return 100% of Fiscal '23 Free Cash Flow to investors through dividends and share repurchases. We expect our quarterly dividend to remain at \$0.50 per share throughout Fiscal '23—with the remainder of Free Cash Flow allocated to share repurchases. We plan to front-end load these share repurchases, with \$500 million coming in the first half of the year, which will reduce share count by 2-3% as we go through Fiscal '23.

#### Now on to Q1 guidance

We expect Q1 net revenues to range between \$1.475 billion and \$1.625 billion which, at the midpoint, implies a 6% increase year-over-year. We expect consolidated gross margin to be approximately 67% and operating margin to be approximately 21%. We anticipate our tax-rate to be between 21 and 22%. And we expect earnings per share for Q1 to range between \$1.05 and \$1.15

per share. Assumed in our Q1 guidance is net interest expense of \$10 to \$15 million and a share count of approximately 224 million.

In closing, I want to thank the entire NetApp team for the outstanding dedication, focus and hustle in delivering strong Fiscal '22 results in a very fluid environment. We remain disciplined and committed to the long-term thesis we shared with you as we continue to navigate the dynamic supply challenges to meet as much customer demand as possible. We are confident, enthusiastic and incredibly focused on our long-term strategic priorities and the tremendous growth opportunity we see over the next several years.

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

**Kris Newton:** Thanks Mike. Operator, let's begin the Q & A.