



**NETAPP
FIRST QUARTER OF FISCAL YEAR 2024
PREPARED REMARKS
AUGUST 23, 2023**

Prepared remarks by:
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George Kurian, Chief Executive Officer
Mike Berry, EVP and Chief Financial Officer

Kris: Hi everyone – thanks 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, including, without limitation, our guidance for the second quarter and fiscal year 2024; our expectations regarding future revenue, profitability and shareholder returns; and other growth initiatives and strategies.

These statements are subject to various risks and uncertainties, which may cause our actual results to differ materially.

For more information, please refer to the documents we file from time to time with the SEC and on our website, including our most recent Form 10-K and Form 10-Q. We disclaim any obligation to update our forward-looking statements and projections.

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

I'll now turn the call over to George.

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

Q1 marks a solid start to FY'24 in what continues to be a challenging macroeconomic environment. We delivered revenue above the midpoint of guidance while our operational discipline yielded operating margin and EPS above our guidance ranges.

As I have outlined on previous calls, we are focused on:

- Managing the elements within our control.
- Reinvigorating efforts to drive better performance in our storage business.
- And building a more focused approach to our Public Cloud business.

We are seeing positive, early indicators from this plan to sharpen our execution, deliver growth, increase profitability, and further strengthen our position for long-term success.

Looking at the results of the quarter, I am especially pleased with the reception to our recent product introductions. The AFF C-series has been the fastest ramping all-flash product launch in our history, with strong demand across all products in the family. Similarly, the AFF A150, our entry-level, high performance all-flash array, grew quickly in its first full quarter of shipping. Our Storage Lifecycle Program is also seeing good early uptake, driving longer-term commitments to NetApp as we help customers future-proof their environments with a world class ownership experience.

Building on this momentum, we introduced more storage innovation in Q1. We announced the ASA A-series, a family of SAN-specific all flash arrays, supported by industry-leading data availability and efficiency guarantees. These systems are the only all-SAN storage arrays with virtual machine and application-granular data protection mechanisms. Complementing our unified storage offerings, they enable us to expand on the tens of thousands of customers who use NetApp for block storage today and drive share gains in the \$18 billion SAN market.

In addition to delivering on our innovation agenda, we have implemented the go-to-market changes we outlined on the Q4 call – focusing our enterprise sellers on the flash opportunity and building a dedicated model for cloud. In May, we held our annual sales kickoff meeting, the first time we've gathered the global team in person since the pandemic. Everyone was energized by the innovation we're bringing to market and the objectives appropriately aligned to each team's strengths. Because many of the products we've introduced open new TAM for us, we are also including training to sharpen our attack on these opportunities. The changes

have been well received, are already showing up in pipeline expansion, and should help drive top line growth in the second half.

Q1 Hybrid Cloud segment revenue of \$1.3 billion was down 12% year over year. Our all-flash array business decreased 7% from Q1 a year ago to an annualized revenue run rate of \$2.8 billion. The demand environment is unchanged from the last half of FY'23, with headwinds from enterprise continuing to weigh on product and AFA revenue. Additionally, as Mike will outline, the first half of FY'23 benefited from elevated backlog, impacting the year over year comparisons.

In the past few quarters, every conversation I've had with customers and investors has touched on artificial intelligence. Generative AI is top of mind for everyone. While still in the early innings of this opportunity, AI is not a new topic for us. We have been a leader in storage for predictive AI and machine learning workloads since we introduced ONTAP AI, a joint NetApp and NVIDIA proven architecture, in 2018. Today, hundreds of customers rely on NetApp storage infrastructure and data management for their AI workloads, including some of the largest pharmaceutical, financial services, and retail companies in the world.

Effective predictive and generative AI projects depend on high quality, well managed, unstructured data. The data pipeline and workflow typically involve data from multiple file and object sources, across cloud and on premises. High performance, highly scalable hybrid cloud storage and data management is a core NetApp advantage and naturally positions us as a leader in this market and will continue to benefit us as the Gen AI market evolves. While early, we are already engaged with customers who are interested in fine tuning large language models with their own data on-premises, as well as those who are leveraging the hyperscalers' Gen AI offerings on the public cloud together with the storage and data management capabilities of NetApp Cloud Volumes services.

Accelerated by the rise of AI, data continues to grow in both volume and value; a company's data is its most valuable asset. Our robust cyber resilience portfolio helps customers ensure they have the right enterprise data protection and security on premises and in the cloud. With built-in features that protect and secure data and deliver rapid recovery based on AI and machine learning, our systems can proactively spot and counter malicious or anomalous actions. Our confidence in our industry-leading capabilities is underscored by the ransomware

recovery guarantee we announced in Q1 and demonstrated by the fact that NetApp is the only enterprise storage vendor on the NSA's classified program components list.

Now, turning to Public Cloud. I want to acknowledge our cloud results have not been where we want them to be and assure you we are taking definitive action to hone our approach and get back on track. At the start of this year, we aligned our cloud sales specialists to our hyperscaler partners' go-to-market structures. Additionally, we are in the process of a strategic review to sharpen the focus of our cloud portfolio, expand on the success of 1st party services, and improve subscription performance. We will have more details to share with you on our next call.

That said, Public Cloud segment revenue in Q1 was \$154 million, an increase of 17% year over year. Public Cloud DBNRR declined to 107%. Within these numbers, strength in 1st party and marketplace consumption services was masked by weakness in our subscription services. Let me emphasize that our strategic focus is on 1st party cloud storage services, and we continue to see customer expansion and deepening partnerships, as well as revenue and ARR growth in this part of the portfolio. Our expectations for FY'24 Public Cloud revenue are reflected in the guidance Mike will walk you through.

First party storage services, branded and sold by our cloud partners, position us uniquely and represent our biggest opportunity. Our partnerships with the cloud providers are strong and delivering growth. Our close and long-standing relationship with Microsoft Azure continues to deliver solid growth. Likewise, our partnership with Google remains strong. In the coming weeks, you can expect to hear exciting news about the expansion of our partnership.

Our relationship with AWS is also yielding positive results. As expected, we are starting to win large enterprise deployments with FSx for NetApp ONTAP. We were chosen to be the cloud storage infrastructure for a global sportswear manufacturer's SAP HANA deployment. FSxN was the only storage service that could meet the company's mission critical service level, availability, and recovery requirements. This is a large, long-term SAP project that will continue to develop and grow over the coming years, driving significant consumption of FSxN capacity. Once completed, it will be one of the largest SAP environments on AWS.

In the face of the challenging macro, demand remains muted, and sales cycles remain elongated. Although customers continue to exhibit caution, they are moving forward with

strategic initiatives, prioritizing investments in applications and technologies that drive business productivity and growth. Our modern approach to hybrid, multicloud infrastructure and data management enables IT organizations to leverage data across their entire estate simply, securely, and sustainably. Customers turn to NetApp to help them increase the performance and reliability of their digital and cloud transformational projects.

Looking forward, our priorities are clear. We will continue to tightly manage the elements within our control, reinvigorate efforts to drive better performance in the storage business, and continue to refine our Public Cloud business. Early results indicate we are on track to drive margin expansion and earnings growth year on year while yielding top line growth in the back half of FY'24.

Before turning the call over to Mike, I want to thank the NetApp team for their continued focus. I also want to remind you we'll be hosting our INSIGHT user conference in person in Las Vegas this October. We hope to see you there.

Mike: Thank you, George. And good afternoon, everyone.

We executed a solid quarter in a challenging macro environment, hitting or exceeding all our guidance ranges. We are delivering on our commitments, evident in our solid Q1 results.

Before I get into the financial details, let me walk you through the key themes for the quarter. As a reminder, all numbers discussed are non-GAAP unless otherwise noted.

- Our disciplined operational management and the strong customer acceptance of our innovation continues to pay off. We expect improved execution and new products will drive growth and operating margin expansion as we move through the second half of the year.
- As expected, Q1 consolidated gross margin was strong. Product margin came in at 55%. Given our expectations for competitive dynamics and product mix, we remain confident in our projection that product margin will hold at these levels through the remainder of the fiscal year.
- Cash from operations was a first quarter all-time high. Operating cash flow benefited from the reduction of premiums, as well as lower component pricing and incentive

compensation payouts. Over the course of FY'24, cash flow should normalize, with operating cash flow tracking relatively in line with non-GAAP net income.

- We returned approximately 120% of free cash flow to stockholders through cash dividends and share repurchases, reducing Q1 FY'24 share count by almost 4% year over year. As we discussed during last quarter's call, we intend to return 100% of free cash flow this year.

Now, to the details of the quarter.

Q1 billings of \$1.3 billion decreased 17% year over year. Revenue of \$1.4 billion decreased 10% year-over-year. The challenging macro environment continued to pressure IT spending. However, as George pointed out, we are well aligned to customers' priority investments and remain confident our go-to-market changes and product innovations will drive growth in the second half of FY'24.

Hybrid Cloud revenue of \$1.3 billion was down 12% year-over-year. Product revenue of \$590 million was down 25%. Remember that first half fiscal year 2023 revenue, most notably product revenue, benefited from elevated levels of backlog, which impacts the year-over-year comparisons. Support revenue of \$611 million grew 2% year over year.

Public Cloud ARR grew 6% year over year to \$619 million. Public Cloud revenue of \$154 million increased 17% from Q1 a year ago. First party and marketplace services grew as customers continue to choose solutions based on NetApp technology for mission critical and cloud native workloads. This growth was offset by underperformance in subscription services. As George noted earlier, Public Cloud did not meet our expectations for the quarter, and we are taking action to hone our approach and reaccelerate growth.

Q1 consolidated gross margin of 71% came in above our guidance, up 400 basis points from a year ago, and again reaching an all-time company high.

Product gross margin was 55%, in line with expectations. As we discussed on the Q4 call, we made strategic purchase commitments to lock-in record low NAND pricing and mitigate rising prices in the future. NAND prices continued to decline in Q1, and we are still positioned favorably versus the market. The potential for increased price competition is factored into our expectations and we remain confident in our ability to hold product gross margin consistent at

this level through the year. Our recurring support business continues to be highly profitable with gross margin of 92%. Public cloud gross margin improved to 67% from 66% last quarter.

As expected, operating expenses of \$703 million were flat year-over-year and grew 4% from Q4'23. The sequential increase was driven by annual merit increases and a reset of incentive compensation, as well as expenses related to our in-person sales kick off meeting.

Q1 again highlighted the strength of our business model and disciplined operational execution with operating margin of 22%, ahead of expectations. EPS of \$1.15 was also above the high end of our guidance.

Operating cash flow was \$453 million in Q1, an increase of 61% year-over-year, driven by lower supply chain payments and variable compensation, partially offset by lower collections.

In Q1, DSO decreased to 41 and inventory turns improved to 13. Free cash flow increased 94% year-over-year to \$418 million, helped by strong operating cash flow and lower cap ex.

During the quarter, we returned \$506 million to stockholders through shares repurchased and cash dividends, ending the quarter with approximately \$600 million in net cash. We have approximately \$1.0 billion remaining on our existing repurchase authorization.

Our balance sheet remains healthy. Total deferred revenue as of the end of Q1 was \$4.2 billion, up slightly from a year ago. We ended the quarter with approximately \$3.0 billion in cash and short-term investments.

Now turning to guidance:

We are reiterating our guidance for the full year. Our total revenue guide is unchanged, with revenue down low-to-mid single digits year over year, measured on a percentage basis. Based on our Q1 results and updated projections, we expect Public Cloud revenue growth to come in lower than initially expected primarily due to softness in our subscription services. This minor weakness is expected to be at least offset by strength in our Hybrid Cloud revenue. We continue to expect FY'24 consolidated gross margin to be roughly 70%, operating margin to be approximately 25%, and EPS to be in the range of \$5.65 to \$5.85. We expect Q2 revenue to range between \$1.455 billion and \$1.605 billion, which at the midpoint implies a decline of 8% year-over-year. If FX rates stay at end-of-July levels, we

would see nearly 2 points of FX tailwinds to revenue. As I called out earlier, first half FY23 revenue benefited from elevated levels of backlog due to last year's supply chain constraints, which impacts the year-over-year comparisons. We expect Q2 consolidated gross margin to be roughly 70%, and operating margin to be approximately 24%. EPS should be in the range of \$1.35 to \$1.45.

In closing, I want to thank our employees, customers and investors for their commitment and investment in NetApp. I am confident in our ability to help our customers successfully achieve their digital and cloud transformation goals. We are well aligned to priority IT investments and are committed to deliver sustainable, long-term value for our stockholders.

I'll now turn the call over to Kris to open the Q & A. Kris?

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