



**NETAPP
FOURTH QUARTER AND FISCAL YEAR 2023
PREPARED REMARKS
May 31, 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 a number of forward-looking statements and projections with respect to our financial outlook and future prospects, including, without limitation, our guidance for the first 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. Welcome, everyone, to our fourth quarter FY23 call.

Our Q4 results reflect solid execution in the face of ongoing macroeconomic challenges. We delivered revenue above the midpoint of our guidance, with disciplined operational management yielding all time

high quarterly operating margin and EPS above expectations. For FY23, we delivered record high annual operating margin and EPS, despite the slow demand environment and relatively flat revenue from FY22.

Even as customers are tightening their budgets in response to the macro, they are not stopping investments in applications and technologies that drive business productivity and growth. Digital transformation projects involving business analytics, AI, data security, and application modernization – both on premises and in the cloud – remain top priorities for IT organizations. This drives our confidence in the health of our markets and future growth opportunity, despite the temporary macro headwinds.

We are participating in the areas of priority spending with a modern approach to hybrid, multicloud infrastructure and data management. By providing customers with the ability to leverage data across their entire estate with simplicity, security, and sustainability, we increase our relevance and value. And we continue to introduce new innovations to deliver greater customer value, further strengthening our position.

On our last call, I outlined our three areas of focus to sharpen our execution to better deliver results while, at the same time, positioning ourselves for long-term success. As a reminder, the focus areas are:

- Remain prudent stewards of the business, tightly managing the elements within our control.
- Reinvigorate efforts across the company in support of our storage systems business.
- Build a more focused approach to our Public Cloud business.

As you can see from our Q4 and FY23 results, we have demonstrated success in managing the elements within our control and staying flexible to adapt to the ever changing environment. We remain committed to maintaining operational discipline as we move through FY24, adjusting as appropriate, to drive operating margin expansion and EPS growth while also continuing to invest for the long-term.

Turning to our storage systems business.

Q4 Hybrid Cloud segment revenue of \$1.4 billion was down 8% year over year and up 4% sequentially. Our all-flash array business decreased 4% from Q4 a year ago to an annualized revenue run rate of \$3.1B. Similar to Q3, headwinds from large enterprises weighed on our product and AFA revenue. As you've seen, we are reinvigorating our storage portfolio, innovating to deliver greater customer value, reach new customers, and better address areas of priority spending and market growth.

ONTAP AI and FlexPod AI are proven and tested reference architectures to help speed and simplify AI deployments. These solutions are designed around our all-flash arrays which are uniquely suited to meet the performance, multiprotocol, and data mobility demands of AI workloads. In Q4, we demonstrated industry leading performance in the GPU Direct benchmark, proof of our ability to enable customers to use the full power of GPU technology for AI. Our affinity to AI use cases doesn't stop at performance; ONTAP includes native data management tools that streamline workflows for data science teams and integrate multi-platform, multi-site, and multi-cloud data pipelines. With new performance and data management features planned in upcoming ONTAP releases, we expect to raise the bar again not just for performance but for total workflow solutions that help companies realize the benefits of AI faster and with better results.

The new AFF C-series, our comprehensive portfolio of QLC-based all-flash arrays, began shipping late in Q4. We are very pleased with the initial customer response. In addition to lots of quoting activity, we closed a good number of deals in the fourth quarter. One of our early C-series wins was a \$15 million deal at a large financial institution for business-critical workloads in its cloud-ready, service-level defined environment. We beat out the competition with a solution that was significantly denser and more energy efficient.

Following this highly successful launch, we introduced the NetApp ASA A-series early in Q1. The ASA is a new line of SAN-specific flash storage systems that deliver high levels of performance, scalability, data availability, efficiency, and cloud connectivity with up to 50% lower power consumption and associated carbon emissions than competitive offerings. The ASA complements our unified storage offerings to address block-only use cases while avoiding the operational and data siloes of competitors' products.

We are also innovating to improve the customer experience. In Q4, we introduced NetApp Advance, a portfolio of programs bringing predictability and adaptability, including the Storage Lifecycle Program for non-disruptive storage upgrades. At the start of Q1, we announced ONTAP One, a simple way to buy and consume all the native software capabilities of ONTAP. We're enhancing the value of these built-in capabilities with our Ransomware Recovery Guarantee, which leverages ONTAP's unique combination of key built-in security and ransomware protection features to detect, stop, and recover from ransomware attacks in real time.

In addition to delivering significant innovation, we have also rebalanced our go-to-market efforts, including focusing our broad sales organization on selling flash through compensation plans and reinstituting a specialist sales team for cloud. We believe these actions will allow the team to better address the large storage TAM. Entering FY24, I am confident that these actions will enable us to

drive product revenue growth and regain share in the all-flash array market. We are seeing early, positive signs, but the full benefit of these changes will take time to develop and should be a driver for product revenue growth in the second half.

While we are sharpening our attack on the storage market, we are not taking our eye off the Public Cloud opportunity. Public Cloud ARR of \$620 million was up 23% year over year and ahead of our expectations, driven by strength in Public Cloud storage services. Our Public Cloud business in Q4 was backend loaded, resulting in softer revenue and lower DBNRR than our ARR results would indicate. Public Cloud revenue for Q4 was \$151 million and DBNRR was 114%.

Our Public Cloud Services are highly differentiated, with a multiyear advantage over our traditional competitors, and they create customer preference for NetApp. The number of total cloud customers, customers using multiple of our Public Cloud services, and customers with greater than \$500,000 of revenue in the quarter all continue to grow nicely. While, like our cloud partners, we see continued cloud optimizations, some of the customers whose optimizations created significant headwinds for us in FY23 have kicked off new projects that we expect to scale over the next 18 months.

We believe that our first party storage services, branded and sold by our cloud partners represent our biggest opportunity. We have aligned our sales specialist resources to our cloud partners' customer segmentation and go-to-market structure to tighten our alignment to and improve our execution against this opportunity. Over the course of FY24, we will scale our customer success team to improve customer retention and expansion and develop a more focused cloud channel model. Cloud Operations remains an important market for us, and we have dedicated go-to-market resources to address this opportunity.

We have not wavered in our conviction that Public Cloud services has the potential to be a multibillion-dollar ARR business for us. While the shift to cloud is experiencing an industry-wide slowdown, the long-term trend in favor of cloud is unchanged.

In conclusion, while FY23 was not the year we expected at its outset, our disciplined management enabled us to overcome a number of headwinds to deliver all-time high operating margin and EPS. The fundamentals of our business model are sound and our confidence in our strategy and the health of long-term opportunity is unchanged.

We are entering FY24 with substantially more innovation and a new, more focused operating model to attack the areas of priority spending. In this uncertain environment, we will remain agile and continue to be disciplined stewards of the business. We believe our actions will drive margin expansion and earnings growth while yielding top line growth in the back half of the year.

Thank you to the NetApp team for their dedication and focus. I am pleased with our progress, but we recognize our work is not done. We look forward to building on this momentum and driving long-term value for our shareholders. I'll now turn the call over to Mike.

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

As George noted, we are laser focused on managing the elements within our control. Our focus enabled us to deliver strong P&L performance for the full year and Q4. Before getting into the details, let me quickly highlight the key themes of our results and expectations for FY24. As a reminder, all numbers discussed are non-GAAP unless otherwise noted.

- We delivered record setting operating margin and EPS above our guidance range in both Q4 and FY23. We will continue to prudently manage the business to position ourselves for long-term success while driving further operating margin expansion and EPS growth in FY24.
- We are confident in the strength of our position and alignment to areas of priority spend. However, macro uncertainties and FX headwinds have pressured IT budgets and lowered spending. We believe these headwinds are temporary and that the spending environment will rebound in time.
- We reached our product gross margin target of mid-fifties ahead of expectations. In FY24, we expect to maintain product gross margin at this level and drive improvement to Public Cloud gross margin.
- In FY23, we returned 148% of free cash flow to shareholders and reduced full year share count by 4% from the prior year. We plan to continue a strong policy of shareholder returns in FY24.

Now to the details.

FY23 billings of \$6.41 billion were down 4% from FY22. Revenue of \$6.36 billion was up 1% year over year. Adjusting for the headwind from FX, billings would have been down 1%, and revenue would have been up 4% year over year. Disciplined operational management yielded all-time fiscal year highs for operating margin and EPS. Operating margin was 24.2%, including a 150-basis point headwind from FX. EPS was \$5.59 and included \$0.57 of year over year FX headwind.

Q4 billings of \$1.67 billion were down 17% year over year, including roughly 2 points of FX headwind. Revenue came in above the midpoint of our guidance range at \$1.58 billion, down 6% from last year or 4%, adjusting for FX.

The uncertain macro negatively impacted revenue in both our Hybrid Cloud and Public Cloud segments, as customers continue to exhibit caution in capital expenditures and look to optimize cloud spend. Hybrid Cloud revenue of \$1.43 billion was down 8% year over year. Product revenue was \$744 million and down 17% from Q4 last year. Support revenue of \$598 million increased 1% year over

year. Public Cloud ARR exited the year ahead of expectations at \$620 million, up 23% year over year. Public Cloud revenue composed 10% of total revenue in Q4 and grew 26% year over year to \$151 million.

We exited FY23 with \$4.31 billion in deferred revenue, an increase of 2% year over year. Growth of deferred revenue is the best leading indicator for recurring revenue growth; Q4 marks the 21st consecutive quarter of year over year deferred revenue growth.

Q4 consolidated gross margin was 69%, above our guidance. Total Hybrid Cloud gross margin was also 69%. Product gross margin was 55%, well ahead of guidance, driven by lower premiums, better mix, and lower FX headwinds. As we've described on previous calls, we expect to retain all the benefit from the reduction in premiums and will be responsive to market pricing of commodity components. Our recurring support business continues to be highly profitable, with gross margin of 92%. Public Cloud gross margin was 66%.

Q4 again highlighted the strength of our business model and our operational discipline with operating margin of 26%, an all-time quarterly high. EPS of \$1.54 was comfortably above the high-end of guidance and included \$0.08 of year over year FX headwind.

In Q4, cash flow from operations was \$235 million and free cash flow was \$196 million. Free cash flow for FY23 of \$868 million came in below expectations due to lower collections and timing of payments. As we noted on our last call, Q4 cash flow included certain one-time restructuring and tax payments, together totaling approximately \$85 million. Inventory turns of 12 were steady from last quarter and last year.

During Q4, we repurchased \$150 million in stock and paid out \$106 million in cash dividends. For the year, we repurchased a total of \$850 million in stock and paid out \$432 million in cash dividends, representing 148% of free cash flow. Q4 diluted share count of 217 million was down 5% year over year. We have approximately \$400 million left on our current share repurchase authorization as of the end of FY23 and today are announcing an additional authorization of \$1 billion.

Our balance sheet remains very healthy. We closed the year with \$3.07 billion in cash and short-term investments.

Now to guidance

Let me underscore our confidence in our strategy and the strength of our position in addressing key customer priorities, like business analytics, AI, data security, and application modernization. However, we expect the macro to remain challenged, with continued pressure on IT budgets and the demand

environment. As a result, we expect FY24 total revenue to be down in the low-to-mid single digits measured on a percentage basis. Public Cloud will continue to be a positive contributor with revenue growth expected in the mid-teens. Implied in our FY24 revenue guidance is year over year growth in the second half driven by sales of recently introduced flash products and benefits from our go to market changes. While we are hopeful that the macroeconomy will improve in the second half of our fiscal year, our plans for FY24 incorporate the environment we are seeing today and do not assume a material change to the economic or demand backdrop.

We expect FY24 consolidated gross margin to be roughly 70%. We believe that product margins will remain approximately 55%, supported by lower premiums and a rotation to higher margin, all-flash products. To take advantage of record low NAND prices, we have made strategic purchase commitments to lock in pricing for a large portion of our expected FY24 SSD demand. This will help us maintain product gross margin levels when component prices rise in the future. We expect to see Public Cloud gross margin improvement in FY24 driven by revenue scale and lower depreciation expense. We remain confident in our long-term Public Cloud gross margin target of 75% - 80%.

We anticipate operating margins of approximately 25% and EPS of \$5.65 to \$5.85. Implied in this guidance is the expectation that we will hold operating expenses roughly flat versus FY23. FY24 op ex includes benefits from the Q4 reduction in force, offset by annual merit increases, a reset of variable compensation, and incremental expenses to support our first in-person sales kick off and Insight user conference since 2019. Operating expenses should be spread fairly evenly throughout the year. We expect a tax rate in the range of 21% - 22%.

Operating cash flow will move in line with net income, although there will be some quarterly variance based on working capital. As we've stated before, FY23 should be the peak for cap ex, with expenditures beginning to come down in FY24. Our healthy cash flow generation enables us to continue our strong program of capital returns to shareholders. In FY24, we intend to return 100% of free cash flow to shareholders in share buybacks and dividends. We plan to hold our quarterly dividend steady at \$0.50 per share throughout FY24, with the remainder of free cash going to share buybacks. We expect the timing of buybacks to be roughly similar to FY23, and to reduce share count by at least 2% in FY24.

Now on to Q1 guidance

We expect Q1 revenue to range between \$1.325 billion and \$1.475 billion, which at the midpoint implies a decline of 12% year over year. Remember that first half FY23 revenue, most notably product revenue, benefited from elevated levels of backlog from supply chain constraints, impacting the year-over-year comparisons.

We expect Q1 consolidated gross margin to be roughly 70% and operating margin to be approximately 20%. EPS should be in the range of \$1.00 and \$1.10. Q1 cash flow will be impacted by payments associated with SSD purchase commitments, partially offset by lower incentive compensation payments year over year related to our FY23 performance.

In closing, I want to echo George's appreciation of the NetApp team and their continued commitment in this uncertain environment. As I look forward into FY24, I am confident in our strategy and our ability to continue to improve our execution and increase profitability.

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

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