



**NETAPP  
FIRST QUARTER OF FISCAL YEAR 2022  
PREPARED REMARKS  
AUGUST 25, 2021**

**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 second 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 execute; and our ability to bring industry leading capabilities to market, 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 Form 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 and thanks to everyone for joining our Q1 fiscal year '22 earnings call.

Building on our accelerating momentum through FY '21, we delivered a strong start to fiscal year '22 with results at the high end or above our guidance for Q1. Broad-based strength drove 12% revenue growth, and 16% product revenue growth year-over-year. Public Cloud revenue grew triple digits again this quarter, up 155% from Q1 a year ago. Our results reflect solid customer demand and strong execution by our team in the quarter.

Cloud and digital transformation initiatives remain top customer priorities and we continue to benefit from these sizeable, long-term trends. Customers need to simplify and modernize existing data centers and deploy

traditional applications quickly and confidently. At the same time, customers are also accelerating their use of cloud, adopting modern application architectures like Kubernetes and microservices for new workloads, and deploying data-rich applications like machine and deep learning. With our Data Fabric strategy, we are uniquely positioned to solve our customers' most significant challenges in both modern and traditional applications, on-premises and in hybrid, multi-cloud environments. As I've said many times, our Public Cloud services not only allow us to participate in the rapidly growing cloud market, they also make us a more strategic data center partner to our enterprise customers, driving share gains in our Hybrid Cloud business.

In Q1, we introduced our new segment reporting disclosures for Hybrid Cloud and Public Cloud, corresponding with how I look at our business. We've provided financial information for both segments in our earnings materials to give you better insight into the dynamics of the two segments. We will maintain our focus on driving growth with our Hybrid Cloud portfolio while scaling our Public Cloud services in fiscal year '22.

In Q1, Hybrid Cloud revenue grew 8% year-over-year, led by outstanding growth in our all-flash array business, which increased 23% to an annualized net revenue run rate of \$2.8 billion. Based on our strong revenue growth, I am confident that we again gained share in the storage and all-flash markets.

In the quarter, we delivered significant innovation that advances our flexible foundation for hybrid cloud, unifies data management across on-premises and cloud environments, and simplifies consumption and operation of hybrid cloud services. We further enhanced the industry's leading and only cloud-ready storage operating system by introducing ONTAP 9.9 with security enhancements, new integrated data protection capabilities, and improved SAN performance. We also released StorageGRID 11.5 with support for data encryption using external key management, ransomware protection with S3 object locks, and increased performance with intelligent load balancing. And we announced a broad range of enhancements to Keystone Flex Subscription with new features for service providers, additional cloud support, a partner-delivered FlexPod as-a-service, and integration with Equinix colocation services.

Public Cloud revenue grew 155% year-over-year, driven by Cloud Volumes, Cloud Insights, and Spot by NetApp. It's been a year since we acquired Spot and we are excited by the innovation we've brought to market under the Spot by NetApp brand and the momentum we have with the Spot offerings. Public Cloud ARR grew to \$337 million, an increase of 89% year over year, and Public Cloud dollar-based net retention rate remains healthy at 192%. Our partnerships with the cloud providers are strong and growing. I am honored that we were recognized by Microsoft as the winner of their Global Customer Experience Partner of the Year and of their U.S. SAP on Azure Partner of the Year awards.

We continue to broaden our Public Cloud services beyond storage and data management services. Today, we help customers, extend, migrate, automate, and optimize the infrastructure and data management capabilities for enterprise and cloud-native applications. Customers use NetApp Public Cloud services because we enable them to use more cloud at less cost. In Q1, we announced Spot PC, a fully managed, secure, and cost-effective cloud desktop as-a-Service for Azure Virtual Desktop and Windows 365. Additionally, we acquired Data Mechanics to accelerate the roadmap for Spot Wave, an infrastructure and application automation and optimization platform for high-growth big data and machine learning workloads in the cloud.

We also continue to deliver on our vision and strategy around application-aware infrastructure and data management for containers. Spot Ocean automates cloud infrastructure for containers, automatically scaling compute resources to maximize utilization and availability with the optimal blend of spot, reserved and on-demand compute instances, reducing costs by up to 90%. In Q1, we evolved Spot Ocean into a suite of DevOps solutions with Ocean Continuous Delivery and Ocean Insights. Ocean Continuous Delivery focuses on the most painful aspects of modern application delivery by automating mission critical deployment and verification processes. Ocean Insights is an analytical tool that gives users a full view of their application clusters and then previews the potential savings from Ocean.

Last year, we introduced Astra Control, a rich set of storage and application-aware data management services for cloud-based Kubernetes workloads. Astra extends the data fabric to the cloud-native world, and in Q1, we extended Astra to be a deployable on-premises software solution – Astra Control Center. Wherever a customer chooses to deploy Kubernetes applications, we can accelerate the deployment, operation, and protection of these critical environments.

Let me share with you a customer story to highlight the value Astra Control Center brings to enterprise customers. As a part of its transformation strategy, a leading telecommunications provider is using a modern IT architecture based on container-native applications. These workloads are mission critical, and the customer turned to NetApp and Astra Control Center to address the challenges of data protection and disaster recovery that don't exist in Kubernetes natively. Additionally, Astra helped them realize their vision of application portability across multiple Kubernetes distributions and data sharing across multiple clusters.

We have long been recognized for our industry-leading enterprise storage and data management technology. Our Public Cloud services drive further differentiation, expand our addressable market, and enable us to reach new customers. We deliver not only industry-leading storage services in the cloud, but also cloud automation and optimization services, and cloud infrastructure monitoring services. You should expect us to capitalize on our advantage by enhancing our go-to-market activities, deepening our cloud partnerships, and delivering best-in-class organic and inorganic innovations. Our strong customer momentum and the uniqueness of our Public Cloud services position furthers my confidence in our ability to reach our goal of \$1 billion in Public Cloud ARR in fiscal year '25.

Our strong first quarter results underscore our value to customers in a hybrid, multi-cloud, data-driven digital world. We are confident that we are well positioned with the right portfolio and strategy to solve our customers' most pressing challenges. With focused execution and demonstrated leadership in hybrid, multi-cloud, we are reshaping the industry. We made a number of innovation announcements this quarter, and we will continue to bring industry-leading capabilities to market, further enhancing our differentiated position in cloud and software.

I am excited for what this year will bring, and I am confident in our ability to deliver top line growth as we support our customers on their cloud and digital transformation journeys.

Before I turn the call over to Mike to walk through our financial results and expectations, I want to thank the NetApp team, our customers, and our partners for an outstanding quarter. I also want to remind you that we'll be hosting our fully digital INSIGHT customer event in October; I hope you will be able to join us.

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.

Fiscal '22 is off to a great start, with strong revenue, gross margin, and operating leverage across the entire business. Excellent execution by the whole NetApp team yielded Q1 billings of \$1.38 billion, up 20% year-over-year. Revenue came in at \$1.46 billion, up 12% year-over-year. Our solid Q1 results were driven by healthy demand across both our Hybrid Cloud and Public Cloud segments. Gross margin, operating margin and EPS all came in above the high-end of guidance.

As George noted, in our earnings materials today, we introduced our new segment reporting disclosures for both Hybrid Cloud and Public Cloud. Hybrid Cloud captures all the revenue streams from our enterprise datacenter business, which include product, support, and professional services. Our Public Cloud segment provides incremental visibility into the revenue and gross margin profile of our rapidly growing cloud business.

Total Hybrid Cloud revenue of \$1.38 billion was up 8% year-over-year. Within Hybrid Cloud, we delivered product revenue growth for the second consecutive quarter and expect this trend to continue throughout Fiscal '22. Product revenue of \$730 million increased 16% year-over-year. Consistent with the trends we saw throughout Fiscal '21, software product revenue of \$414 million increased 33% year-over-year, driven by the continued mix shift towards our all-flash portfolio.

Total Q1 recurring support revenue was \$578 million, flat year-over-year. Excluding the 14<sup>th</sup> week from last year's compare, recurring support revenue was up 8% year-over-year.

As George highlighted, Public Cloud ARR exited Q1 at \$337 million, up 89% year-over-year and 12% sequentially. Public Cloud revenue recognized in the quarter was \$79 million, up 155% year-over-year. The growing scale of our Public Cloud platform continues to positively impact the overall growth profile of NetApp—delivering 4 of the 12 points in revenue growth.

When combined, software revenue, recurring support and Public Cloud revenue totaled \$1.1 billion and increased 17% year-over-year, representing 73% of total revenue versus 71% in Q1 '21.

Recurring support and Public Cloud revenue of \$657 million was up 8% year-over-year, constituting 45% of total revenue. Excluding last year's 14<sup>th</sup> week from the compare, recurring support and Public Cloud revenue was up a healthy 16% year-over-year.

We ended Q1 with over \$3.9 billion in deferred revenue, an increase of 8% year-over-year. Q1 marks the 14<sup>th</sup> consecutive quarter of year-over-year deferred revenue growth, which continues to be the best indicator of the health of our recurring revenue.

Total gross margin of 69% was an all-time company high, reflecting the value of our software portfolio and Public Cloud platform. Total Hybrid Cloud gross margin was also 69% in Q1. Within our Hybrid Cloud segment, product gross margin was 55% and benefited from the continued mix shift towards software-rich all-flash systems. Our 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. This is a major milestone for the Public Cloud business as we continue to build out a diversified portfolio of cloud-based software

offerings. We expect this trend to continue as an increasing percentage of our Public Cloud business is built on software-only solutions.

Q1 highlighted the tremendous leverage in our operating model, with operating margin of 23% -- an all-time high for our Q1. EPS of \$1.15 came in above the high-end of guidance and was up 58% year-over-year.

Cash flow from operations was \$242 million and free cash flow was \$191 million. During Q1 we repurchased \$100 million in stock and paid out \$112 million in cash dividends. In total we returned \$212 million to shareholders, representing 111% of free cash flow. We closed Q1 with \$4.5 billion in cash and short-term investments.

As you all know, the supply chain situation remains fluid. Our excellent supply chain and procurement team continues to work closely with our partner ecosystem, with the goal of keeping backlog and customer lead-times at normal levels. Towards this goal, we will continue to invest incrementally into inventory and longer-term commitments to help mitigate any potential supply risks. Aiding this effort is the fact that we have a singular software platform that powers all our key storage products, which provides us added flexibility to work with our contract manufacturers and customers to meet end demand.

With our strong execution in Q1 and our expectation of continued growth for the remainder of the year, we are raising our fiscal '22 guidance across the board. We now expect revenues to grow 8 to 9% year-over-year, with billings growth expected to outpace revenue growth given the continued strength in recurring support contracts and our Public Cloud platform. We also have growing confidence in our Public Cloud opportunity and are raising the low-end of our fiscal '22 guide; we now expect to exit fiscal '22 with Public Cloud ARR of \$450 to \$500 million, driven by enhanced go-to-market activities, deeper cloud partnerships and continued product innovation. As George noted, we are solidly on track to deliver on our commitment to eclipse \$1 billion in Public Cloud ARR in fiscal '25.

In fiscal '22, we expect total gross margin to be approximately 68%, with product margin of approximately 55% for the full year. We anticipate operating margin to range between 23 to 24%. Operating expense expectations remain unchanged at \$2.75 to \$2.8 billion, driven by continued investment in revenue generating activities, including expanding our Public Cloud portfolio, targeted investments in go-to-market resources and continued investment in our customer success sales team. As we discussed at our investor day last September, we continue to grow revenue faster than operating expenses.

We are committed to delivering \$4.85 to \$5.05 in fiscal '22 EPS—representing 22% year-over-year growth, at the mid-point. Implied in this guidance is our expectation that other income and expense will be a negative \$60 to 65 million and our effective tax-rate will remain at 19%.

We now expect to generate more than \$1.2 billion in free cash flow in fiscal '22, as our Hybrid Cloud business continues to fund the growth in our Public Cloud platform.

We are committed to the capital allocation framework we outlined during our Q4 call. The dividend will remain the first call on capital, while share repurchases will continue to play a key role in our capital allocation strategy. 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 free cash generation will go towards our acquisition strategy, which will remain focused on bolstering our strategic Public Cloud roadmap.

Now on to Q2 guidance. We expect Q2 net revenues to range between \$1.49 billion and \$1.59 billion which, at the midpoint, implies a 9% increase year-over-year. We expect consolidated gross margin to be approximately 68% and operating margin to be approximately 23%. Assumed in this guidance are Q2 operating expenses of \$690 to \$700 million. We anticipate our tax-rate to be approximately 19%. And we expect earnings per share for Q2 to range between \$1.14 and \$1.24 per share. Assumed in our Q2 guidance is our expectation that other income and expense will be a negative \$15 to \$20 million. As a reminder, Q2 tends to be our seasonal trough for free cash flow; this is further compounded by the one-time tax payment associated with the sale of our Sunnyvale campus.

In closing, I want to thank the entire NetApp team for working tirelessly throughout Q1 to maintain the momentum we had exiting last year. We are at a unique inflection point in the company's history as we continue to build out a truly differentiated Public Cloud platform, while maintaining an unwavering focus on the Hybrid Cloud business. As a result, we are more confident than ever in our ability to deliver long-term value to our shareholders, customers, and partners as we execute against both opportunities.

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?