



**NETAPP
THIRD QUARTER OF FISCAL YEAR 2024
PREPARED REMARKS
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Prepared remarks by:
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George Kurian, Chief Executive Officer
Mike Berry, EVP and Chief Financial Officer

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 fourth 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 on our Q3 FY24 call.

I'm pleased to report that we delivered exceptional performance across the board despite an uncertain macro environment. Revenue was above the midpoint of our guidance, driven by the momentum of our expanded all-flash product portfolio. This strength coupled with continued operational discipline yielded company all-time highs for consolidated gross margin, operating margin, and EPS for the second consecutive quarter.

Entering FY24, we laid out a plan to drive better performance in our storage business and build a more focused approach to our Public Cloud business, while managing the elements within our control in an uncertain macroeconomy to further improve our profitability. These actions have delivered strong results to date, support our raised outlook for the year, and enhance our position for the long-term.

Only NetApp delivers a comprehensive architecture based on a single operating system that supports any application or data type, spans on-premises and multiple cloud environments, and is available in traditional capex or as-a-service procurement models. Our unified data solutions address some of the biggest priorities IT organizations face today – modernizing legacy infrastructure, improving resiliency against ransomware attacks, and building scalable, high performance data pipelines for AI workloads. The consistent operations, common management tools, integrated data services, and unique and proven capabilities for hybrid cloud of our unified storage architecture provides customers the ability to simplify at scale and lower storage costs. Our silo-free approach to unified data storage is clearly resonating with customers, driving healthy demand for our products and services, and positioning us well to deliver long-term growth.

Turning to the results of the quarter.

We delivered robust year-over-year performance in our Hybrid Cloud segment with revenue growth of 6% and product revenue growth of 10%, driven by momentum from our newly introduced all-flash products and the go-to-market changes we made at the start of the year. Strong customer demand for our industry leading all-flash solutions drove all-flash growth of

21% year-over-year to an all-time high annualized revenue run rate of \$3.4 billion. In Q3, our all-flash business expanded to approximately 60% of Hybrid Cloud segment revenue. As Mike will detail, we expect a sustainable step up in our baseline product gross margin going forward with the continued revenue shift to all-flash.

The AFF C-series all-flash arrays again exceeded our expectations, delivering new-to-NetApp customers and numerous wins over the competition. As customers modernize legacy 10k hard disk drives and hybrid flash environments, we are displacing competitors' installed bases with our all-flash solutions, driving share gains. Our newly introduced ASA families of SAN-optimized high-performance and capacity-oriented all-flash arrays also outperformed our expectations. We're excited about the enormous potential in the nearly \$20 billion SAN market. Our modern all-flash SAN arrays, backed by industry-leading data availability and efficiency guarantees, are well-positioned to redefine the competitive landscape. In Q3, we had numerous competitive take-outs across a broad set of workloads and vertical markets as customers leveraged our C-series and ASA products to modernize their legacy infrastructures and deploy new applications like artificial intelligence.

We continue to see strong interest in our advanced portfolio of ransomware protection solutions. We help customers take proactive steps to protect, detect, and recover their data. Competitive solutions focus only on data recovery, but NetApp keeps data protected and secured from the start with products designed to block cybersecurity risks and mitigate the high cost of downtime. ONTAP is the first enterprise-class storage solution validated by the NSA for the Commercial Solutions for Classified Program, demonstrating the strength of our state-of-the-art data protection and cybersecurity solutions.

We saw good momentum in AI, with dozens of customer wins in the quarter, including several large NVIDIA SuperPOD and BasePOD deployments. We help organizations in use cases that range from unifying their data in modern data lakes to deploying large model training environments, and to operationalize those models into production environments. To best take advantage of Generative AI capabilities, customers are looking to augment foundational models with their own data. Our high-performance, scalable unified data storage systems create intelligent data pipelines that allow customers to capture, aggregate and prepare their data for AI. NetApp delivers the data management capabilities for security, performance, and

simplicity that enterprises require for their Gen AI workflows. We continue to advance our position with the development of Gen AI driven cloud and on-premises solutions in partnership with industry leaders.

Demand for consumption options is also growing as some customers look to increase budget flexibility in an ongoing uncertain macro and higher interest rate environment. However, this is not a universal mandate. Our unified data storage solutions are available as capex, as-a-service, and cloud native offerings providing customers with the widest range of buying options, enabling them to meet their budget requirements. Keystone, our Storage-as-a-Service offering, delivered another strong quarter, with revenue growing triple digits from Q3 a year ago. Keystone is a great solution for customers who want a cloud-like operating model on premises. For customers who are ready to move to the cloud, we uniquely partner with the leading hyperscalers to deliver cloud-native storage services.

Public Cloud segment revenue was \$151 million, up 1% year-over-year. First party and hyperscaler marketplace storage services remain our priority and are growing rapidly, with the ARR of these services up more than 35% year-over-year. These offerings are highly differentiated and tightly aligned to customer buying preference. We continue to deepen our hyperscaler partnerships, and deliver growth in customer count, capacity, revenue and ARR with this part of the portfolio.

As I outlined last quarter, we are taking action to sharpen our approach to our Public Cloud business. As a part of this plan, we exited two small services in the quarter. We also began the work of refocusing Cloud Insights and InstaClustr to complement and extend our hybrid cloud storage offerings and integrating some standalone services into the core functionality of Cloud Volumes to widen our competitive moat. In Q4, we anticipate approximately \$20 million in ARR headwinds from unrenewed subscriptions. This will create minimal revenue impact and should be largely offset by growth in first party and marketplace services. We will continue refining our focus in FY25, building a stronger base from which to grow.

Our hyperscaler partnerships and natively integrated storage services position us to address the new and emerging gen AI opportunity in the cloud. A leading open-source developer of gen AI tools, datasets and models is leveraging AWS' FSx for NetApp ONTAP as a part of its

offerings. The customer was looking for a high-performance and resilient file storage solution to train extensive AI/ML workloads. FSxN gave them a scalable solution with performant storage for intensive AI model training. As a fully managed service, FSxN removes operational burdens, allowing their DevOps team to focus on business value activities.

In summary, we entered the final quarter of FY24 in a much stronger position than we were at the start of the year, despite the on-going macro uncertainty. Our modern approach to unified data storage, which spans data types, price points, and hybrid multicloud environments, is resonating in the market.

We are successfully executing against our top priorities – growing in all-flash and cloud storage services. We are well positioned with an expanded TAM including block storage and new market opportunities like AI to drive continued growth and share gains. We are moving to a higher product margin profile supported by growth in all-flash products, and we will continue to maintain the operating discipline that has yielded record profitability.

I am very pleased with our momentum and very confident in our ability to deliver positive outcomes for customers and stockholders.

Finally, I want to make you aware of our June 11 investor day where we will provide an update on our long-term strategy and business model. Now, I'll turn the call over to Mike.

Mike: Thank you, George, and good afternoon, everyone. As a reminder, all numbers I will discuss today are non-GAAP unless otherwise noted.

Our focus and strong execution again delivered record-setting results, reaching all-time highs across key profitability measures including consolidated gross margin, product gross margin, operating margin, net income, and EPS.

Before I discuss the financial details, let me walk you through the key themes for the quarter.

- As George noted, we continue to see positive results from our new all-flash products and the go-to-market changes we implemented at the start of the fiscal year. The momentum

from our industry-leading flash portfolio, coupled with our operational discipline, drove both top and bottom-line growth in the quarter.

- Q3 consolidated gross margin of 73% and product gross margin of 63% were both at all-time highs for the second consecutive quarter. Gross margin leverage and operating discipline drove operating margin of 30% and EPS of \$1.94, both also setting company records for the second consecutive quarter.
- Q3 operating cash flow came in at \$484 million and free cash flow was \$448 million. We expect operating cash flow for the full year to be at least \$1.3 billion, tracking relatively in-line with net income.
- The strong execution of our priorities of winning in flash and growing first party cloud services are clearly paying off. Given our strong execution of results that met or beat our guidance ranges, while driving record-setting profitability measures for the second consecutive quarter, we are once again raising our full year revenue and EPS guidance. Looking ahead, we are even more confident in our position to drive long-term revenue growth and profitability.

Now, to the details of the quarter.

Q3 billings increased 7% year-over-year to \$1.7B and revenue increased 5% year-over-year to \$1.6B driven by momentum with our all-flash array product families. Hybrid Cloud revenue increased 6% year-over-year to \$1.5B, and product revenue increased 10% to \$747M year-over-year.

Support revenue grew 2% year-over-year to \$631 million. We are pleased with the success of moving the responsibility for the majority of our renewals to the customer success team implemented as part of our go-to-market focus.

Public Cloud revenue grew 1% year-over-year to \$151 million. As expected, growth was driven by our first party and marketplace cloud storage services, offset by declines in subscription services.

Now for our operating results.

Q3 consolidated gross margin was 73%. Gross profit margin dollars increased 14% year-over-year to \$1.2 billion, driven by strong growth of product gross profit dollars. Q3 product gross profit of 63% was 250 basis points higher than the high-end of our guide, primarily driven by better-than-expected mix shift to all-flash products and pricing discipline in what remains a cost-sensitive environment.

Operating expenses of \$682 million increased 5% year-over-year, and declined slightly from Q2, as expected. As a result of operating leverage and disciplined management, Q3 operating profit dollars increased 30% year-over-year to \$485 million, and operating margin increased 580 basis points from a year ago to 30%, a record for the second consecutive quarter.

EPS grew 42% year-over-year to a record high of \$1.94. Our tax rate was 18%, lower than expected, due to an adjustment of our full year tax rate. Normalizing for a tax rate of 21.5%, EPS would still have been a record high of \$1.86.

Q3 operating cash flow of \$484 million was up 28% year-over-year and free cash flow was up 40% year-over-year driven by solid billings and profitability. DSO was 45 and inventory turns were 14, both consistent with expectations. Year-to-date operating cash flow of \$1.1 billion increased 23% year-over-year.

During the quarter, we returned \$203 million to stockholders through share repurchases and cash dividends, ending the quarter with approximately \$526 million in net cash. Year-to-date, we have generated \$963 million in free cash flow and returned more than 100% to stockholders.

Our balance sheet remains healthy. Total deferred revenue as of the end of Q3 was \$4.1 billion, down 2% year-over-year. We ended the quarter with approximately \$2.9 billion in cash and short-term investments.

Before moving to Q4 and FY24 guidance, I would like to spend a few minutes discussing our product gross margin expectations going forward.

We have seen the price increases on NAND from suppliers and these increases will impact all industry participants. The mix-shift to our higher-margin all-flash products will partially offset the headwinds from these price increases going forward.

As a result of our shift to all-flash, we expect product gross margin to expand to the upper 50% to 60% from our historical norm of approximately 55%. Please note, in any given quarter, commodity prices, product mix, and the pricing environment will cause product gross margin to fluctuate from this new baseline. That being said I want to make sure to reiterate this point: even with the increase in commodity costs we fully expect our product gross margins to expand to the upper 50% to 60% level driven by the shift to our all-flash portfolio.

Now let's turn to guidance.

As George noted, we are pleased with the results of our focus and continued operational discipline.

Given our better-than-expected results and our improved outlook for Q4, we are again raising our FY24 revenue guidance to a range of \$6.185 to \$6.335 billion, or \$6.26 billion at the midpoint. We expect to see continued strength in all-flash products and hyperscaler first party and marketplace services.

FY24 consolidated gross margin is expected to be in the range of 71% to 72%. Product gross margin is expected to be approximately 60%, driven by the continued favorable mix shift to all-flash products.

Operating margin is expected to be approximately 27% and EPS to be in the range of \$6.40 to \$6.50, with the assumption of net interest income of approximately \$40 million and share count of 212 million. Our full year tax rate is projected to be 20%. We expect operating cash flow for the full year to be at least \$1.3 billion.

In Q4, we expect revenue to range between \$1.585 and \$1.735 billion, which at the midpoint of \$1.66 billion implies an increase of 5% year-over-year. We expect Q4 consolidated gross margin to be roughly 71%, and product gross margin to be approximately 60%. Operating margin is projected to be in the range of 27% to 28%. Implied in this guidance, we expect operating expenses to increase from Q3 due mainly to higher incentive compensation, the

timing of marketing programs and targeted investment to drive key product roadmap items. Our tax rate is expected to be 20% and EPS is expected to be in the range of \$1.73 to \$1.83. Also please note that our purchase commitments for NAND for FY25 demand will impact our cash flow and balance sheet in Q4, which is included in our updated cash flow forecast and will result in inventory turns to be in the 8- 10x range.

In closing, I want to thank our customers, partners, employees and stockholders for their unwavering commitment and investment in NetApp. We continue to prove our ability to manage the elements within our control and our solid top-line results demonstrate the value that customers realize from our products and services. Our innovative portfolio is well-aligned to priority IT investments and we remain committed to delivering 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.