



**NETAPP
SECOND QUARTER OF FISCAL YEAR 2021
PREPARED REMARKS
DECEMBER 1, 2020**

Prepared remarks by:
Kris Newton, VP, Investor Relations
George Kurian, Chief Executive Officer
Mike Berry, EVP and Chief Financial Officer

Kris: 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.

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 the third quarter fiscal year two thousand twenty one; our expectations regarding future revenue, profitability, and shareholder returns; and our ability to return to growth, gain share, and scale our cloud business, 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 including the continuing impact of the COVID-19 pandemic; the IT capital spending environment; and our ability to gain share in the storage market, scale our cloud business, generate cash flow and execute our capital allocation strategy.

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, and our current reports on Form 8-K.

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: Thanks, Kris. Good afternoon everyone. I hope you and your loved ones are safe and healthy. Thank you for joining us on our Q2 FY21 earnings call.

NetApp delivered another strong quarter with revenue, operating margin and EPS all exceeding our guidance. I am pleased with our continued progress in an uncertain market environment. The improvements we made to sales coverage in FY20 and our tight focus on execution against our biggest opportunities continue to pay off. We saw strength in all geographies with larger customers accelerating their digital transformations with NetApp. We will continue to exploit competitive transitions, the growth of the all-flash market, and the accelerating shift to cloud to expand our leadership position.

It was a busy quarter for us. We hosted an investor day; held our annual customer conference; and introduced significant new products and services which further advance our Data Fabric strategy. I want to thank the team for their focus on execution and customer success, especially in these challenging conditions.

At our investor day, we introduced our vision for a new NetApp – a cloud-led, data-centric software company. We are building the new NetApp on a strong foundation. We are a trusted partner to the world's leading organizations who are undertaking digital transformations. We have unique strategic partnerships with the leading clouds, including deeply integrated technology and go-to-market efforts. And we have a strong business model, with a proven track record of turning market transitions to our advantage.

We laid out a plan to scale our cloud business while growing and gaining share in the storage market. These foundational elements fuel growth in our high-margin software, cloud services and recurring maintenance revenue streams. This, coupled with our disciplined opex management, balanced approach to investing for growth, and sustained capital returns – will create significant long-term shareholder value.

As you can see from our Q2 results, we are successfully executing against this plan. Cloud services ARR grew to \$216M, an increase of 200% year over year. Our cloud services dollar-based net

retention rate remains very healthy at 207%. We are pleased with the mix of new cloud services customers and growth at existing customers.

We saw continued success with our Run-to-NetApp competitive takeout program, an important component of our strategy to gain new customers and win new workloads at existing customers. Our all-flash business grew 15% year over year to an annualized run rate of \$2.5 billion. We believe we gained share again in this important market. At the end of Q2, 26% of our installed systems were all-flash, giving us opportunity for continued growth by converting our installed base, in addition to winning new customers with our industry-leading all-flash solutions. Growth in all-flash drove momentum in software product revenue, which increased 14% year over year, and recurring maintenance and cloud revenue, which increased 11% from last year.

As I discussed last quarter, we are learning to thrive in the new normal of working remotely with each other, our customers, and our partners. We held our Insight customer conference digitally, and it was arguably our most successful one to date. We were joined by industry luminaries from our partners and customers, all talking about how NetApp gives the world's leading organizations the freedom to put data to work in the applications that elevate their business and our commitment to helping customers exploit the opportunity of digital transformation by building data fabrics. We had a record number of attendees, including a dramatic increase in the number of prospects and first-time attendees.

While we couldn't meet face-to-face, we had thousands of customer and partner engagements. The interest in and excitement for our Data Fabric strategy and hybrid multi-cloud solutions was unmistakable. We bring enterprise-grade data services to the cloud and the simplicity and flexibility of the cloud to the enterprise data center. We are helping customers manage their data far more effectively for digital transformation and tackle the challenges of hybrid cloud. No matter where an organization is on its hybrid cloud journey, NetApp can help it achieve its goals.

In the quarter, we announced dozens of industry-leading innovations to further help customers digitally transform to thrive in a hybrid cloud world. Our software driven portfolio allows companies to redefine how they manage data, storage, and infrastructure, whether in the cloud or on premises.

We introduced serverless and storageless solutions for containers, autonomous hybrid cloud storage and data management, and elastic scale for the modern workplace. New Spot services automate cloud infrastructure for containers through the continuous analysis of how containerized applications use compute and storage to automatically adjust the infrastructure to the optimal blend, saving customers costs and radically simplifying management. Cloud Manager provides a centralized console with full visibility and control to automate management of all NetApp hybrid, multi-cloud storage and data services, such as backup, tiering, and compliance. And with our Virtual Desktop Management Service, companies can rapidly deliver comprehensive cloud-based workplace solutions with continuous optimization of resources.

We also unveiled the latest version of our flagship operating system – ONTAP 9.8. ONTAP is at the heart of our approach to hybrid cloud. We enhanced the ONTAP data services to provide integrated caching across the widest range of workloads and physical data locations, enable flexible, cost-effective, instantaneous failover for business-critical applications, and support object storage with S3 protocol access. Additionally, we introduced new end-to-end NVMe systems, SAN-optimized systems, and hybrid arrays to give customers a broad range of price and performance options.

Finally, we made updates to NetApp Keystone Flex Subscription, providing a fast, flexible path to a cloud-enabled data center with “pay-as-you-grow” subscriptions for a cloud-like experience on premises. Keystone enables our customers to consume their Data Fabric with a cloud like experience in their data center, as a managed service in addition to the public cloud. Only NetApp is able to offer customers this flexibility.

Together, all of these innovations better enable enterprises to accelerate their digital transformation and adapt rapidly to unpredictable business demands.

Let me share with you a couple of digital transformation stories to illustrate how we are helping customers put their data to work to elevate their businesses.

A leading US healthcare provider is using AI solutions from NetApp to improve patient care and experience. Our AI control plane and Kubernetes integration enabled us to displace Dell and the early success of our initial deployment has resulted in expansion to additional workloads. We are now the foundation for everything from patient check-in to AI-based radiology and pathology.

At a dominant US-based retailer, NetApp was selected to support the work of 500 data scientists, with plans to expand to 1,000. These engineers are using data to create AI-driven recommendations to increase sales and improve customer satisfaction. NetApp supported their need to quickly increase their online services during the pandemic as the foundation for an AI-based service so customers could virtually try new products.

It's clear that Covid-19 has reshaped the environment. Digital transformation is now a necessity requiring speed and agility to respond to changing business conditions. Hybrid cloud is the de facto IT architecture at digitally transformed enterprises for the foreseeable future. Having an integrated, flexible data management foundation is critical to the success of digital transformation efforts. Because of this, data is growing in scale and importance and we believe that NetApp is a primary beneficiary of this trend.

I am confident in both our long-term opportunity and our ability to execute against it. Our unique position in helping the world's leading organizations solve the challenge of managing their most critical data fuels our ability to win in the market. We are committed to driving disciplined growth, extending our hybrid cloud leadership, effectively expanding our business, and ensuring that we remain well positioned for the future. Our growing margin-rich software and recurring maintenance and cloud revenues support our ability to deliver value for customers and shareholders.

I'll now turn it over to Mike to walk you through the results of quarter. Mike?

Mike: Thanks 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 George noted, we delivered revenue, operating margin, and EPS above the high-end of guidance. Importantly, solid execution across the company yielded Q2 billings of \$1.46 billion dollars, up 10% year-over-year. This is our second straight quarter of year-over-year billings growth.

In Q2, net revenue of \$1.42 billion dollars increased 3% year-over-year, including a point of currency tailwind. Our two key strategic focus areas, our industry-leading all-flash storage business and Public Cloud Services, both outperformed our expectations in the quarter.

When combined, software revenue and recurring maintenance and cloud revenue totaled 1 billion dollars, increased 12% year-over-year and represented 72% of total revenue. We ended Q2 with

\$3.7 billion dollars in deferred revenue, an increase of 5% year-over-year. Deferred revenue is the leading indicator for future recurring revenue growth. And as we highlighted at our recent Investor Day, all-flash systems carry higher maintenance dollar content relative to the rest of our portfolio.

As George highlighted, our all-flash revenue of \$632 million dollars was up 15% year-over-year, positioning us for share gains for the second consecutive quarter. Only 26% of our installed systems were all-flash at the end of Q2—providing a very healthy runway for our flash business.

Public Cloud Services delivered an impressive \$216 million in ARR, growing 200% year-over-year and 21% sequentially—with organic ARR growth accelerating for the second straight quarter. We continue to see strong demand from our customer cohorts with Q2 dollar-based net retention rate coming in at 207%. We are on track to deliver on our commitment of \$250 to \$300 million in Fiscal '21 Cloud ARR and remain confident in our ability to eclipse \$1 billion in Cloud ARR in Fiscal '25.

Total product revenue of \$749 million dollars decreased approximately 3% year-over-year. In the quarter we saw good engagement from both enterprise and public sector accounts as customers continued to embrace digital transformation and hybrid cloud projects. Software product revenue of \$417 million dollars increased 14% year-over-year, driven by an increase in mix of our high-end all-flash systems.

Recurring maintenance and cloud revenue of \$599 million was up 11% year-over-year, constituting over 42% of total net revenue.

Gross margin of 66.9% was at the high-end of guidance. Product gross margin was 53%, up 160 basis points sequentially and ahead of our expectations. The outperformance was driven by better all-flash mix. We expect product margin to remain at this level throughout the remainder of Fiscal '21.

Our recurring maintenance, cloud and other services business continues to be a very profitable and growing business for us, with gross margin of 82.6%.

Q2 operating expenses of \$657 million dollars were in-line with our expectations. Operating margin was 20.6% and EPS was \$1.05, demonstrating the strong operating leverage in our business model.

Cash flow from operations was \$161 million dollars and free cash flow was \$121 million dollars, representing 9% of revenue. As a reminder, Q2 tends to be our seasonal trough for free cash flow.

During the quarter we paid out \$107 million dollars in cash dividends, representing 88% of free cash flow. As you know, we paused our share repurchase program the last 2 quarters because of the macro backdrop. More recently, we have been encouraged by the stability in our business, broader macro trends and the recent positive results of several Covid-19 vaccine trials. As a result, we plan to reinstate our share repurchase program during Q3, making progress towards our commitment to offset dilution from our equity plans. We ended Q2 with \$3.6 billion dollars in cash and short-term investments.

Now to guidance. We expect Q3 net revenues to range between \$1.34 billion dollars and \$1.49 billion dollars which, at the midpoint, implies a 1% increase in revenues year-over-year and includes a point of currency tailwind. We expect consolidated gross margin to be approximately 67% and operating margin to be approximately 20% in Q3. Assumed in this guidance are operating expenses of \$660 to \$670 million dollars. The sequential increase in opex is being driven by the annual reset in U.S. payroll taxes and healthcare benefits. We anticipate our non-GAAP tax-rate to be between 16 and 17%. And we expect earnings per share for Q3 to range between \$0.94 and \$1.02 per share. Assumed in this guidance is interest expense of \$15 to \$20 million dollars.

In closing, I want to thank the entire NetApp team for the hard work and commitment in delivering another great quarter. We remain well positioned to take advantage of the market transitions George highlighted and capitalize on the big opportunity ahead.

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

Kris: Thanks Mike. We'll now open the call for Q&A. Please be respectful of your peers and limit yourself to just one question so we can get to as many people as possible. Operator?