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Seagate Technology Plc (STX)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, and welcome to the Seagate Technology Fiscal Second Quarter 2021 Financial Results Conference Call. My name is David, and I will be your coordinator for today. At this time, all participants are in a listen-only mode. Following the prepared remarks, there will be a question-and-answer session. As a reminder, this conference is being recorded for replay purposes.

At this time, I would like to turn the call over to Shanye Hudson, Senior Vice President, Investor Relations and Treasury. Please proceed, Shanye.

Shanye Hudson

Senior Vice President-Investor Relations & Treasury, Seagate Technology Plc

Thank you. Good afternoon, everyone, and welcome to today's call. Joining me are Dave Mosley, Seagate's Chief Executive Officer; and Gianluca Romano, our Chief Financial Officer. We've posted our earnings press release and detailed supplemental information for our December quarter on the Investors section of our website.

During today's call, we'll refer to GAAP and non-GAAP measures. Non-GAAP figures are reconciled to GAAP figures in the earnings press release posted on our website and Form 8-K that was filed with the SEC. We've not reconciled certain non-GAAP outlook measures because material items that may impact these measures are out of our control or cannot be reasonably predicted. Therefore, a reconciliation to the corresponding GAAP measures is not available without unreasonable effort.

As a reminder, this call contains forward-looking statements, including our March quarter financial outlook and expectations about our financial performance, market demand, industry growth trends, planned product introductions, ability to ramp production, future growth opportunities, possible effects of the economic conditions worldwide resulting from the COVID-19 pandemic and general market conditions. These statements are based on management's current views and assumptions and information available to us as of today, should not be relied upon as of any subsequent date. Actual results may vary materially from today's statements.

Information concerning our risks, uncertainties and other factors that could cause results to differ from these forward-looking statements are contained in our most recent Form 10-K and 10-Q filed with the SEC, our Form 8-K filed with the SEC today, and the supplemental information posted on the Investors section of our website. As always, following our prepared remarks, we'll open the call for questions.

With that, I'll turn it over to you, Dave.service

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

Thank you, Shanye. Welcome, everyone, and thanks for joining us today. Seagate exited calendar year 2020 on a very strong note, delivering December quarter performance that exceeded our objectives. Compared to the prior quarter, we grew revenue 13%, expanded non-GAAP operating profits 31%, and significantly increased free cash flow to $314 million.

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We began executing our recently increased share repurchase authorization and retired over 18 million shares of Seagate stock or approximately 7% of the shares outstanding beginning of the quarter. Due to combination of share repurchases, and our quarterly dividend, we returned a total of $1.2 billion in the quarter.

Despite the challenges of the global pandemic, Seagate grew annual revenue 2% in calendar year 2020, achieving revenue growth inside of our long-term financial target range. At the halfway point of fiscal 2021, our performance puts us well under way to achieving our objective to deliver relatively flat revenue for the year.

In the remainder of my comments today, I'll provide an update on end market trends, share the progress we've made on our technology and product roadmaps, and offer some insight into how these advancements position Seagate with a strong secular mass data growth trends ahead.

Against the backdrop of the pandemic, 2020 was headlined by diverging end market trends. Strong cloud investments to support our remote economy and digital transformation were countered by significant disruptions to enterprise IT spending.

However, during the December quarter, the enterprise markets began to recover for the first time since the onset of the pandemic. The improvement was most pronounced amongst large enterprise OEM customers, which led to strong sequential revenue growth for both nearline and mission-critical drives. We anticipate this positive trajectory to continue, which is consistent with analyst expectations for on-prem, IT hardware investments to pick up in calendar year 2021.

Cloud data center demand remains healthy with the overall data demand drivers intact. Analysts projected strong double-digit growth in cloud CapEx in 2021, which bodes well for Seagate and aligns with our expectation for cloud HDD storage demand to increase through the balance of the fiscal year and drive significant growth longer term.

For a second consecutive quarter, we experienced stronger than expected growth in video and image applications or VIA markets due in part to a pent-up demand following the significant impacts incurred in these markets during the economic shutdowns early in the pandemic. Video and image applications are key growth markets within mass capacity storage.

As the number of devices generating data explodes at the edge, mass capacity HDDs are vital to preserving and putting data to work. For example, the rollout of 5G and rise of edge computing supports further growth in smart and safe city initiatives, as well as smart factory opportunities.

Gartner projects the number of 5G-enabled outdoor video cameras to exceed 15 million by 2023, a six-fold increase from current levels. That will translate to as much as 1 exabyte of data generated each day, enough to fill about 2 million security surveillance drives every week.

Proliferation of video and image sensors and other IoT devices is expected to be a major driver of data creation at the edge in the coming years and will play a key role in the growth and evolution of the mass data storage industry.

Finally, strong seasonal demand for our desktop, PC and consumer drives contributed to double-digit sequential revenue growth in our legacy business during the December quarter.

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Overall, we expect demand for mass capacity storage to improve across the cloud and enterprise markets in the March quarter, more than offsetting an expected decline in the VIA markets and the typical seasonal slowdown in the consumer space. With the broader market environment continuing to firm, Seagate is executing well on its technology roadmap and hitting our imminent milestones, highlighted by the shipments of our first 20-terabyte HAMR drive in late November.

With HAMR, we can drive areal density compound growth rates of 20% or higher to support the scale of our customers' infrastructure investments and enabling Seagate to maintain a significant economic advantage for mass capacity applications relative to enterprise SSDs and that's expected to persist over the foreseeable future.

Seagate's first-to-market dual actuator technology is gaining interest among a broader customer base who require mass capacity storage with higher performance for certain applications such as content delivery. We are increasing shipments of dual actuator drives today and expect to see higher volumes as drive capacities increase.

We are also continuing to strengthen our PMR product roadmap, anchored by our industry-leading 16-terabyte drives based on our common scalable platform. We broadened the adoption of 16-terabyte drives in the December quarter, gaining new cloud customers globally. We have started to increase the pace of the 18-terabyte product ramp, which will continue through the calendar year, consistent with the strong progress of our qualifications and customer readiness timing.

As drive capacities increase, the qualification process often takes longer and adds complexity. Our common platform approach is helping customers simplify the qual process. In fact, a number of leading cloud customers commented that the qualification of 18 terabytes has been the smoothest ever. Additionally, we expect to continue to leverage the quality and scalability of this platform, which is extendable through 20-terabyte on PMR technology. The strength of this platform offers Seagate the flexibility to meet customers' timing and mass storage needs.

For Seagate, the common platform strategy drives manufacturing efficiencies that allow us to ramp new technologies and production more quickly and then use our systems business to accelerate the pace of learning and market adoption. We are maintaining solid momentum in our system sales, securing multiple customer wins in the December quarter, including our biggest systems deal ever, a multi-quarter deal representing close to eight exabytes of scalable storage.

Overall, with our leadership in HDD technology and execution on our product roadmap, Seagate is in excellent position to capture the $24 billion mass capacity storage opportunity that we forecast for 2025, which is driven by the burgeoning demand for data. However, to capture value from the avalanche of data being created, CIOs must overcome cost, scale, and complexity challenges associated with moving, analyzing, and storing more data across the distributed enterprise.

As a result, economics are forcing enterprises to keep proportionately less of the data that's being created, which threatens business performance and competitive advantage. This dynamic is at the foundation of Seagate's innovation agenda. We are enabling CIOs to address the key challenges of cost, scale and complexity to preserve and put to work more of the valuable data they are already creating.

Our Lyve Storage Platform offers a simple, cost-efficient, and secure way to manage massive volumes of data across the distributed enterprise. Lyve Mobile enables mass data transfer between the endpoints edge and core and Lyve Rack powered by CORTX open source, object-based software provides enterprises with the lowest cost per petabyte.

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CORTX software is the foundation of Lyve Storage Platform and is maintained by a growing community of data scientists and enterprise storage experts, many of whom participated in our first ever and highly successful Hackathon event held last month at Lyve Labs, Israel. We have a growing customer interest for the Lyve portfolio and continue to receive positive feedback on our existing engagements that span multiple verticals, including media and entertainment and autonomous vehicle technologies.

Driving platform level innovation and addressing the growing challenges faced by the distributed enterprise is a mandate that will help define our long-term growth strategy. We plan to share more details on the Lyve Storage Platform and the rest of our unfolding strategy on February 24 when we will be hosting a virtual analyst and investor event. I look forward to having you join us.

With that, I'll now turn it over to Gianluca to walk through the December quarter.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Plc

Thank you, Dave. Seagate continue to execute well and adapt to the rapidly changing business environment as shown by our strong December quarter performance, which was supported by the anticipated recovery in the enterprise market, record revenue for video and image application and a seasonal demand for our consumer and desktop PC product. We achieved revenue of $2.62 billion, up 13% sequentially and above our guidance midpoint.

Non-GAAP EPS of $1.29, up 39% sequentially exceeding the high end of our guidance range and free cash flow of $314 million, up nearly 70% sequentially, reflecting our ongoing focus on operational efficiency.

Additionally, we repurchased 18.2 million shares of Seagate stock. Our decision to invest in our shares in the current environment underscores our confidence in the long-term business outlook and future cash generation abilities.

In the December quarter, we shipped a record of 129 exabytes of hard disk drive capacity, up 13% sequentially and 21% year-on-year. Roughly three-quarters of our total exabytes were shipped into the mass capacity market, which include nearline, VIA, and NAS product.

Mass capacity shipments increased to a record 97 exabytes in the December quarter. We shipped a total of 365 exabytes in the calendar year 2020, up 59% year-over-year, which is well ahead of the long-term CAGR forecast of about 35% for this market segment. Our current outlook for the March quarter support continued exabyte shipment growth, setting a strong start for calendar year 2021.

On a revenue basis, HDD accounted for 92% of total December quarter revenue and mass capacity storage represented 62% of HDD revenue. Revenue from mass capacity storage was $1.5 billion, up 12% sequentially and 15% year-over-year.

Nearline revenue increased sequentially, driven by stronger than expected demand from enterprise and OEM customers. Nearline shipments were 71 exabytes, up 11% sequentially and 45% year-on-year, reflecting ongoing demand for our 16-terabyte high-capacity drive, as well as increased demand for mid-capacity nearline products as the enterprise market recover.

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This dynamics resulting in average capacity per nearline drive staying relatively flat at 11.4 terabyte. We are continuing to expand adoption of our 16-terabyte drive and expect 16 terabyte to remain the company highest revenue product over the next couple of quarters. We will also continue to increase shipment of our 18-terabyte drive and make positive progress on qualification plan at multiple cloud customer with volume ramp aligned with their timing.

In the VIA market, revenue was above our expectation for the second consecutive quarter as pent-up demand from the COVID-related pause in the first half of the calendar year led to strong recovery in the September quarter and record revenue in the December quarter. Following this period of strong demand, we anticipate the March quarter sales to be sequentially lower and below typical seasonal trend.

The legacy market represented 38% of December quarter HDD revenue compared to 37% in the prior quarter and down from 47% in the year ago period. Revenue and exabyte shipment both increased 15% sequentially, resulting in a total of 32 exabyte shipped into the legacy market.

The growth was driven by a seasonal uptick for consumer drives and desktop PCs and improving demand for mission critical drives, consistent with recovery in the enterprise market, which also impacts demand for our mission critical drives. We currently expect the ongoing enterprise market recovery to moderate the seasonal decline we typically see in the March quarter.

Our non-HD (sic) business made up 8% of December quarter revenue, relatively flat on a percentage basis with the prior quarter. As chosen partner for Microsoft Xbox expansion card, Seagate benefit from strong holiday demand which supported both double-digit growth for our SSD product and a sequential improvement in non-HDD revenue.

Within our system business, we saw early sign of recovery at large OEM customers which along with the customer wins Dave mentioned earlier should benefit our system business in calendar 2021.

In the December quarter, non-GAAP gross profit increased to $704 million compared with $614 million in the September quarter. COVID-related cost increased slightly to $28 million, primarily due to elevated shipping cost. We are currently planning to incur similar level in the March quarter as we balance customer demand timing with increasing higher freight cost and opportunities to utilize lower cost ocean freight.

Our resulting non-GAAP gross margin was 26.8%, including about 110 basis points impact from this COVID-related cost. HDD margin expanded slightly quarter-over-quarter, offset by a less favorable non-HDD product mix.

Non-GAAP operating expenses came in at $319 million, down $31 million from the same period last year, reflecting ongoing benefit from working from home and overall operational efficiency. Looking ahead, we expect operating expenses to be a bit higher in the March quarter.

Our resulting non-GAAP operating income was $385 million and non-GAAP operating margin was 14.7% of revenue, up 200 basis points sequentially and in the upper half of our long-term target range of 13% to 16% despite the COVID headwind I mentioned earlier.

Based on diluted share account of approximately 251 million shares, non-GAAP EPS for the December quarter was $1.29. The $0.19 outperformance relative to our guidance midpoint was driven mainly by higher revenue and operational leverage while our share repurchase activity enhanced EPS by $0.05.

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Capital expenditures were at $159 million in the December quarter, which represented approximately 6% of revenue. We expect CapEx to represent between 4% and 5% of revenue for the fiscal year, which is below our prior target of 6% to 8% of revenue. We believe this CapEx level will align supply with demand when considering the existing installed base capacity and continuing demand growth for mass capacity storage.

Days inventory standing reduced by eight days sequential. Inventory value was relatively flat at $1.3 billion in anticipation of continuous strong mass capacity storage demand in the near-term as well as the need to carry higher level of strategic inventory to better manage freight logistics and protect against potential future supply chain risk.

We expect inventory level to gradually decline as freight costs return to more normalized level and we consume this critical component. We generated $314 million of free cash flow from the December quarter, up from $186 million in the September quarter and up 10% year-on-year, supported by our focus on operational efficiency and improvement in demand trend and a strong linearity.

In the December quarter, we used $167 million to fund our dividend and utilized $1 billion to retire approximately 18 million ordinary shares, exiting the quarter with 240 million share outstanding. We will continue to opportunistically retire Seagate stock and return capital to our shareholders.

Additionally, we raised a total of $1 billion in capital, issuing two tranches of debt at the lowest ever interest rate of any of our bond. Including the new notes, gross debt was $5.1 billion and the net debt was $3.3 billion. We expect the interest expense for March quarter to be approximately $59 million, including $9.5 million from the two new tranches.

Cash and cash equivalents remain relatively stable at $1.8 billion. As a new calendar year begin, we expect strong cloud data center demand and continued enterprise recovery in the March quarter to more than offset the seasonal decline in some of our other end market. While we are still facing headwinds from COVID-related cost, we expect this will gradually decrease over the next few quarters.

Taking all these factors into account, our outlook for the March quarter is as follows. Revenue is expected to be $2.65 billion, plus or minus $200 million. Non-GAAP operating margin is expected to be in the mid of our target range of 13% to 16% of revenue and non-GAAP EPS is expected to be $1.30, plus or minus $0.15.

In closing, Seagate is executing well across multiple levels, delivering on our financial commitments, demonstrating the ability of our business model for the customer demand, and maintaining our commitment to return cash to our shareholders.

I'll now turn the call back to Dave for final comment.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

Thanks, Gianluca. 2020 was a very challenging year and many have and continue to face hardships. We are encouraged by progress with vaccines and signs of recovery. Through the efforts of our extended team, Seagate exited the year firing on all cylinders and we're well- positioned to capture mass data growth opportunities in calendar 2021 and beyond.

We are executing our technology innovation road map to continue delivering the lowest cost mass data storage. We are strengthening our mass data infrastructure portfolio by building on the positive momentum of our scalable

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common platform family of 16- and 18-terabyte drives, we are gaining interest for our Lyve Storage Platform which expands Seagate market opportunities, paving the way for future growth.

Our success is founded on the dedication of our employees and the ongoing support of our suppliers, customers, and shareholders. Employees remain the lifeblood of our company and we are focused on maintaining and strengthening our culture to provide an open, safe, and respectful workplace and ensure all employees are able to thrive.

Earlier this month, Seagate released its latest diversity, equity, and inclusion report. I'm proud of Seagate's strong track record and reputation for promoting inclusion both within and outside the walls of the company, and recognizing diversity is key to our ongoing success.

We're equally focused on contributing to our customer success, which we believe will lead to higher revenue for Seagate and greater value for our shareholders. We collect data quarterly to measure overall satisfaction across the breadth of our customer base. The December quarter indicators were among our highest ever, which reflects the care we take in providing high quality, reliable products for all of our customers. In summary, I'm excited about Seagate's growth opportunities, ability to generate cash, and enhance shareholder value over the long-term.

With that, Gianluca and I are happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Karl Ackerman with Cowen. Your line is open.

Karl Ackerman
Analyst, Cowen & Co. LLC

Q

Hi. Good afternoon, everyone. Thanks for taking my question. Dave, I've got a question for you to start. With on-prem still recovering, are you able to achieve 35% exabyte growth for your nearline business in fiscal 2021? I ask because I think you indicated in your prepared remarks that while customers are still suggesting 18 terabyte offers a very attractive upgrade path, maybe adoption timing is a bit elongated.

And then second, I think you noted that your 20-terabyte drive could facilitate exabyte growth of I think 20% or more a year. Could you just touch on your longer term exabyte growth expectations as well? That'd be very helpful. Thank you.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Thanks, Karl. Thanks for the question. Yeah, 35% is still in the cards, to answer your question directly. What's astute about your question is there is a mix between the highest capacities and then the on-prem tends to be a little lower capacity nearline, so it could be 8 or 12 terabytes. But we still think 35% is a good number through the fiscal year exactly to your point.

Longer term, I think we've said 35% is fairly consistent. The cloud may actually grow bigger than that, but we have to wait and see kind of some of the reverberations after COVID. But I still think that's a good number for bit growth in the mass capacity markets even further than just the end of the fiscal year.

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Karl Ackerman
Analyst, Cowen & Co. LLC

Q

Got it. If I may, just hoping if you could touch upon shortages. I think with shortages of semiconductor components and even diodes, does that preclude you from ramping your higher capacity drives, even particularly your 20-terabyte drive?

And then second, are you able to extend your volume commitments within – with data center providers given the shortages across the supply chain? Thank you.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. Two interesting questions. The first thing is one of the reasons we really like the common scalable platform is we're flexible on questions exactly like you just asked. So, relative to componentry, we have long visibility but if we were changing platforms over and over and over again, then some of those things might be hard to chase, and the fact that we have more capacity and inertia on those platforms, I think, gives us a lot of flexibility.

But, to your point, I think across all the supply chains, people are witnessing some of these kind of constraints and people are managing way out in front of them. And I do think it's forcing discussions to be a little bit more mature relative to what the mass capacity needs are, what the needs are of silicon. For example, I think you've made reference to in some of the other components and making sure everybody has enough for the growth of our customers, especially during recovery times and what they might need later on in the calendar year.

Shanye Hudson
Senior Vice President-Investor Relations & Treasury, Seagate Technology Plc

A

Thanks, Karl.

Operator: Your next question comes from the line of Katy Huberty with Morgan Stanley. Your line is open.

Katy L. Huberty
Analyst, Morgan Stanley

Q

Good afternoon. Thanks for the questions. Just with the improvement in demand that you've seen in a number of the end markets, can you talk to us qualitatively about where you are in terms of manufacturing utilization versus either a quarter ago or a year ago? And I ask because we have started to hear that some hyperscalers can't get all the product they want. We've seen some price increases in the channel. I'm just wondering how tight things got in the seasonally strong December quarter and what that might mean for the next couple of quarters.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. Katy, thanks. So in some of the markets that were tremendously disrupted, some of the legacy markets, for example, we had ample capacity throughout the period of Q1 and Q2, the COVID impact – pandemic impact. And a lot of the supply chains were disrupted as well.

The cloud demand has been fairly strong and predictable for us. We were building what we had predicted. I think the way I think about our capacity constraints or our manufacturing constraints, if you will, is more the long lead time stuff like wafer capital and some of those things, wafer process time and things. Things like that staging for the future, that's the stuff that's full.

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At drive level, we still have some flexibility, and we did last quarter. And so we were able to chase really aggressively say the VIA markets in particular that were kind of racing ahead. And there were some seasonality there but some of it was just pent-up demand based on how the impacted or the pandemic had impacted [indiscernible] (00:29:37) all the supply chain. So if that's helpful, the longer lead time, out-front manufacturing capacity we have is building up to your point. We saw some flexibility to drive them.

Katy L. Huberty
Analyst, Morgan Stanley

Q

Okay. And then just to follow-up, Gianluca, can you just bridge how you're thinking about the March quarter gross margin relative to December? Just some of the plus and minuses sequentially on gross margin, which seems like it's up slightly based on your guidance.

Gianluca Romano
Chief Financial Officer & Executive Vice President, Seagate Technology Plc

A

Yeah. First of all, the December quarter margin has already improved sequentially, especially in the hard disk part of the business with maybe some negative impact on the SSD and system solution segment. But the hard disk starting to improve already in the December quarter.

That mix is going in the right direction, as we said in the script. Enterprise OEM was strong in December. Cloud was still very healthy and now, when we go into the March quarter, we expect both segments to actually continue to improve sequentially.

We will lose a little bit of the legacy segment, a little bit of surveillance. We think mission-critical will be maybe less seasonal than what we have seen in the past, and they are now helping the quarter and the gross margin in the quarter. So I think we will continue to go in the same direction.

Of course, we'll have some of the costs from COVID that continue to be there. It was fairly high in the December quarter, a little bit higher than what we were expecting and now, we think March will probably be fairly similar.

Katy L. Huberty
Analyst, Morgan Stanley

Q

Great. Thank you for that and congrats on the quarter.

Gianluca Romano
Chief Financial Officer & Executive Vice President, Seagate Technology Plc

A

Thank you.

Operator: Your next question comes from the line of Sidney Ho with Deutsche Bank. Your line is open.

Sidney Ho
Analyst, Deutsche Bank Securities, Inc.

Q

Thanks for taking my question. I got a couple of them. So maybe first one on the nearline side, maybe two parts here. On the enterprise side, you talked about some recovery you've seen last quarter. How far do you think we are still below the trend line? The question is more on the on-prem nearline drives, but feel free to talk about mission critical.

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But on the cloud side, have you seen any kind of delays or pull forward in capacity transitions in some of your large cloud data center customers compared to what you think a few months ago?

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. Okay. Sidney, I'll take – kind of two parts. So first, just the enterprise, if you will, the on-prem that we said during the early days of the pandemic was probably the most impacted. That is recovering somewhat. I think it's recovering slowly because some of the on-prem dynamics have not fully resolved themselves and probably still won't. But it is recovering slowly and it's more predictable now so that's why we feel like we understand the market. This is kind of in line with the IDC numbers we quoted in the prepared remarks as well. The traditional IT is going to be up 3% and I think that goes exactly to that point.

On the bigger cloud service providers around the world, there's a lot of dynamics going on because there's no one-size-fits-all cloud obviously. But I would say in general, a lot of applications pushed into the cloud and people had to react there with the budgets that they had, with the technology they had, with the platforms that they had and so on. And in some cases, they prioritized away from whatever storage infrastructure they were building on. In other cases, they prioritize to it so it's fairly complicated right now.

My opinion is that because of the dynamics we've just seen, the cloud's going to grow even bigger than what we'd forecast and so over the long-term, we're projecting mass capacity will be $24 billion market in 2025. So we think there's strong secular growth coming in the cloud, but it is still choppy based on some of the dynamics that we just talked about.

Sidney Ho
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Maybe a quick follow-up, I know I asked this question last quarter on Huawei, but given the current restrictions on the shipment to Huawei, does that change the way you think about the total addressable market for this calendar year for nearline drives?

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Yes. So like I said last time, we don't comment on any specific customers. I think that the market demand globally will not change on how it's ultimately serviced, so if that answers your question. So, the net demand for data storage products is out there and it'll get serviced by one customer or another, by one supply chain or another, and these are very, very complex supply chains.

Sidney Ho
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thank you.

Operator: Your next question comes from the line of Thomas O'Malley with Barclays. Your line is open.

Thomas O'Malley
Analyst, Barclays Capital, Inc.

Q

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Good afternoon, guys. Thanks for taking my questions. My first one is really around capital returns. You obviously thought it was strategic to spend a decent amount in the quarter and picked up some shares. Can you talk about what your view is on buying back more shares over the next couple of quarters? And then obviously, with the new debt rolled into the model as well, how will you view the pros and cons between paying some of that down and also buying back the shares?

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. Tom, obviously it's kind of two parts of the question. There's what we just went through in the pandemic and the way we were looking at the market. The bigger part is that looking forward, I really believe in the long-term cash generation capabilities of the company. So our decision to invest in our shares is weighing current environment and long-term business outlook and cash generation capabilities.

I do think that – if this is helpful, that we're kind of at an inflection point in data growth. I mean we – from Seagate's perspective, we had to do a lot of transition from client server businesses, factory transitions and so on into mass capacity. We've kind of finished that and now, we're seeing mass capacity growing just simply because the demand for data is growing, at the edge opportunities and things like that.

So I think that this is an interesting time relative to all that. We look at the opportunistic – the ability to retire stock, return capital. We look at the investments we have to make in ourselves. We have a fairly strong thesis on all this and it's good to have cash generation capabilities to underpin and also, we can make the trade-offs.

Thomas O'Malley
Analyst, Barclays Capital, Inc.

Q

That's really helpful. The next one is just a high level question, totally fair if you answer from a very high level as well. But clearly, there's a lot of concerns about flooding the market with big capacity NAND this year. How do you think in a market in which the cost environment on the flash side is decreasing, particularly legacy markets will react? Obviously, you mentioned some seasonality in the first quarter, but do you think that you'll see greater than expected declines there or could you just talk through the pros and cons of what you may see happening throughout this year if that flash environment weakens?

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah, sure, if it helps. A few years ago, the narrative was very different when notebooks hadn't transitioned over and now, they largely have transitioned over to NAND. So I look at things like that as places where the two technologies are competing head-to-head and that doesn't really exist anymore. People talk about, for example, mission critical drives and this is a little bit of inside baseball here, but mission critical drives, for us, we haven't really done a new platform in quite a few years.

We're continuing to service market that's out there. There's a large number, tens of millions, maybe even more than that of slots that are out there, the SAS interface on them that have good value proposition. So we'll continue to service this market, but I don't think a small change or even a fairly large change in the NAND price changes that dynamic because the new architectures are not SAS architectures, generally speaking. Some of them – they're NVMe architectures and that's where you need to be designing products for.

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So the overlap, if you will, between the two markets is not super relevant and in the mass capacity markets, it's night and day difference. In massive data infrastructure, a small change in cost, even a large change in cost is not going to make a difference in the architecture decisions that people are making.

Gianluca Romano
Chief Financial Officer & Executive Vice President, Seagate Technology Plc
A

I think, Dave, this is a important point in the segments that are really growing like cloud and enterprise OEM and even surveillance. But not really overlap between hard disk and NAND at this point and we don't expect that to happen in the next few years actually.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc
A

Yeah. The way I look at the datasphere. There's a big growth in edge and cloud, and there's lots of different architectural components. NAND has definitely come of age and so it's got a lot of opportunities. [ph] It has to (00:38:36) design the right solutions for the customers and from that capacity perspective, we have the exact same problem. We keep driving our road map and we're going to be just fine.

Operator: Your next question comes from the line of Steven Fox with Fox Advisors. Your line is open.

Steven Fox
Analyst, Fox Advisors LLC
Q

Hi. Thanks for taking the question. Good afternoon. I'm just having trouble footing everything you said with the new CapEx advice of 4% to 5% of sales. I know you were thinking it might not be as high as 6% to 8% previously but can you just sort of talk about what's going into that decision? And then I had a follow-up.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc
A

Yeah. I'll let Gianluca take it, Steve.

Gianluca Romano
Chief Financial Officer & Executive Vice President, Seagate Technology Plc
A

Yeah. Basically, what happened in the last couple of years, Seagate, and I think in general the industry, installed more capacity than what was needed. So the fact that the growing demand is now absorbing that capacity is obviously good news for the industry and for Seagate in particular. But we can still see some of additional capacity not being fully utilized. So we don't need to invest more in the short-term at least in order to absorb the demand and serve that demand.

So we think that still investing now a fairly high amount, that is now 4% or 5% of our revenue, is not a small number. It's a big number but that is the right level for us to align supply and demand in the next, I would say, two or three quarters.

Steven Fox
Analyst, Fox Advisors LLC
Q

Okay. That's helpful. And then just maybe, Dave, if you can give a little bit more color on the 18TB rollout. I know you've said consistently it is dependent upon when your customers want kind of some uptick. But is there any

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other color you can provide in terms of what may drive it sooner rather than later or later than you expect based [indiscernible] (00:40:38)?

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. We did say in the script that the 18-terabyte qualifications have gone very well. To the earlier point, I don't think – from a mass capacity perspective, we're not in the era in the industry anymore of just build a bunch and then try to ship them in at the end of a quarter or something like that. You have to have real good relationships with the customers, know exactly what they want.

So we – over the last few quarters, we've been on a theme in communicating this with you that we know our 18 terabytes was going to be what the customers were going to be asking us for, and so we were fairly clear with that. And the ramp has begun, though, and so – and it starts by going back to wafer, which was many, many months ago and then making sure we're starting the right parts.

We are making the transition to that product right now and we feel really good about it. We feel good about the quality levels, the yield levels, the ability to ramp, all the components that we need because it's a common platform. I think we've been signaling this pretty well. I can't really comment on what the rest of the industry is or isn't doing because I just don't know. But that's relative – that's the way I look at our plans.

Steven Fox
Analyst, Fox Advisors LLC

Q

Okay. Appreciate that color. Thanks very much.

Operator: Your next question comes from the line of Aaron Rakers with Wells Fargo. Your line open. Aaron Rakers with Wells Fargo, your line is open.

Aaron Rakers
Analyst, Wells Fargo Securities LLC

Q

Sorry about that guys, I was on mute. I wanted to build on the last question with regard to kind of the visibility discussion. When I look at kind of growing your mass capacity at 35%-plus this year, it seems to really imply a very, very healthy uptick in capacity shipment growth into these next couple of quarters.

So, as we think about the visibility in the business, the change in dialogue that you've had with kind of your key customers, how would you characterize visibility into that kind of demand profile, that pickup of capacity shift into the back half of the year? And I do have a quick follow-up.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Hi, Aaron. Thanks. Yeah, I think it's not just about the highest capacity point exactly what you're pointing out and we have good visibility on 16TBs and what our customers needed. We have good visibility on 18TBs because we talked to those customers about exactly what they need in multi-quarters out as well. But there's also something going on at 8 terabytes and 12 terabytes and so on.

So if you see that kind of transition based on the products that serve the lower capacity points of the mass capacity market, if you will, that's where we start to see some significant growth as well. And that tends to be more global than isolated in a few accounts so – but that gives us confidence. And by the way, the platform that

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we have or the platform transitions we're making, take costs in disks and heads and things like that out as we increase capacity, we can actually do that there. So, we are confident in our ability to go solution that better as the mix increases. So go ahead with your follow-up.

Aaron Rakers
Analyst, Wells Fargo Securities LLC

Q

Okay. Yeah and just as a quick follow-up, given the mix of business and kind of what's transpired over the last year plus, I'm just curious on how do you think about the variables, the drivers that gets you back to that kind of what I think you've characterized as a normalized gross margin into that 29 – the 30-plus percent range.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. As Gianluca mentioned before, HDD is almost there. I mean there's some other dynamics of other businesses but exactly to your point, we have these new platforms coming that will necessarily take cost out. We have to make sure that there's – we're actually getting the customers what they need, but I do expect some demand growth recovery again in some markets but also growth as well that allow everything to equilibrate more and get us back into the range.

It was a very competitive market in the times of COVID 2020 and people were trying to keep their factories full and things like that. Now, we're into a period of – with this growth and recovery, like Karl asked earlier, there's a lot of questions about supply availability, making sure you have the right supply at the right time. And we're into those kinds of discussions as well and we expect that to stabilize.

Aaron Rakers
Analyst, Wells Fargo Securities LLC

Q

In less than a quarter.

Gianluca Romano
Chief Financial Officer & Executive Vice President, Seagate Technology Plc

A

Thank you. Aaron, I think it's a combination of different items. Of course, the focus for us is always on cost reduction, and I think we are achieving that level of cost quarter-after-quarter. The second very important item is this alignment between supply and demand that should bring a healthcare (sic) [healthy] pricing environment for the industry.

And then, of course, there are those additional costs that we are incurring right now because of the COVID situation that we don't expect to continue forever. We think a few more quarters and then hopefully that part of the cost will go away.

Aaron Rakers
Analyst, Wells Fargo Securities LLC

Q

That's great. Thank you.

Gianluca Romano
Chief Financial Officer & Executive Vice President, Seagate Technology Plc

A

Thank you.

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William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc
A

Thanks, Aaron.

Operator: Your next question comes from line of Kevin Cassidy with Rosenblatt Securities. Your line is open.

Kevin Cassidy
Analyst, Rosenblatt Securities
Q

Thank you for taking my question and congratulations on the strong results. Maybe first with the enterprise customers coming back, have they been qualifying higher density drives, or is that going to just start now? Was there a delay? And what are the expectations going forward?

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc
A

Yeah. Typically, Kevin, some of the enterprise customers do lag. They don't qualify the highest capacity points or the branded product as fast as some other people do. There are exceptions to that rule, but they do lag. There's not really been any slowdown in qualifications for any reason. I think people have, even through the challenges, the logistical challenges of COVID, people have kept focused on what they need to do because they're seeing efficiency gains as well there. But as we make some of those transitions, I think that helps us answer the enterprise demand the right way as the enterprise demand is starting to grow again.

Kevin Cassidy
Analyst, Rosenblatt Securities
Q

Okay. Thanks. And just as a follow-up with the 16-terabyte and moving over to the 18-terabyte and the visibility you talked about, do you see a crossover of shipments anytime in 2021 or is that more of a 2022 calendar year event?

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc
A

Yeah. It's not going to happen this quarter or next quarter but just because of the sheer volume of the 16-terabyte. But I do see it at some point, yeah, and we're going to ramp really hard. I mean, it's the same platform so it's not hard for us to ramp per se. There's also other efficiencies that we get by driving to the 18-terabyte platform, so that's why we're pretty excited about it.

Kevin Cassidy
Analyst, Rosenblatt Securities
Q

Okay. Great. Thank you.

Operator: Your next question comes from the line at Patrick Ho with Stifel. Your line is open.

Patrick J. Ho
Analyst, Stifel Financial Corp.
Q

Thank you very much and congrats on a nice quarter. Dave, maybe as a follow-up to Kevin's last question about the 16-terabyte to 18-terabyte transition, obviously the 16-terabyte has been a big share gainer for Seagate. And

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you mentioned the EV platform transition to 18 terabytes. First, how do you look at, I guess, new customer wins with 18 terabytes?

And maybe secondly, on top of that question, do you see more incremental share gains when you get – I guess, when you move to 20 terabytes and above on the HAMR platform where there are, I guess, significant differentiation versus your peers?

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Thanks, Patrick. Yeah, I don't really think about market share per se. I think about talking to the customers about what exactly they need. Now to your point, there are people who were on 14-terabyte, for example, or 12-terabyte and said, I'm going to 18-terabyte. And so they've been waiting the transition a little bit. And so we'll work with them on those transitions and make sure that we have an ample supply for them.

As we go even higher, I can't really speak to – I can only speak to the discussions that we're having. I have confidence in 20-terabyte ramps. We made comments in the script about PMR capabilities to get there. We have the HAMR capabilities to get there. I think we control those levers very carefully. So, whatever a specific customer would want performance-wise or whatever we can get them for their new architecture, old architecture because there's still a lot of legacy architecture, there's even replacement architectures we have to service, we'll go out and do that.

So it's not to be flippant, but I just don't think about share gains, rather I think about what do these customers that we're talking to need exactly from us and making sure we're aligned.

Patrick J. Ho
Analyst, Stifel Financial Corp.

Q

Great. And my follow-up question for Gianluca in terms of OpEx, you guys have done a really good job flexing OpEx during especially these challenging times in 2020. How do you look at OpEx and especially R&D given now that you're starting to release HAMR-based products? Is there an ability to "flatten out" R&D in the near term with maybe a lot of the heavy-lifting related to HAMR, I don't want to say out of the way, but at least a lot of the initial ramp and start-up costs embedded?

Gianluca Romano
Chief Financial Officer & Executive Vice President, Seagate Technology Plc

A

Yes. Actually we have done that already, so you see the result already at least partially in our result of the quarter. For the long-term, I think last quarter we said probably a good model is around $330 million per quarter. Right now we are a little bit below. And no, we will try to stay below as much as possible. Of course, we know we always look at opportunity for cost reduction, especially right now in the technology space where we have developed HAMR also we don't have the need for maybe all the spending that we had in the past.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah, it's a really good point. There is the HAMR technology, smallest laser ever shipped and the smallest waveguide ever shipped and dialing it down to something, a 30-nanometer spot size or whatever it is. This is a really, really difficult technology. We've invested a lot to get to where we are. Really proud of where we are being able to ship some units and get the learning out there and start building the volume and everything else. We don't

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have to go through that investment again. And so, that we get a lot of scale from here. So, yeah, I appreciate your question.

Patrick J. Ho
Analyst, Stifel Financial Corp.

Q

Great. Thank you.

Operator: Your next question comes from the line of Ananda Baruah with Loop Capital Markets. Your line is open.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Hey. Thanks, guys. Good afternoon, Happy New Year and congrats on solid results here. Two if I could. First Dave, I guess sort of the 35% mass capacity exabyte growth for the year actually implies that the June quarter, and then the March Q, guys, implies the June quarter is really the quarter where it kind of kicks off.

And then you had made some remarks, I think in the prepared remarks, about calendar 2021. I don't want to – I'd really ask, looking for clarification that you said sort of continues through the year. And so I'd love to get – well, first of all, could you just sort of comment on, if the June quarter does kick off in a meaningful way from the March quarter and then what your thoughts are on the September and December quarter as well? And then I have a follow-up for Gianluca.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. Thanks, Ananda, and Happy New Year to you too. So, yeah, looking forward, we do see recovery and mass capacity, there was obviously the VIA markets that grew last quarter and then have their normal seasonal downtick. But the cloud will continue to grow from here in exabytes. And so that underpins the forecasts that we have right now.

It is still early, we haven't seen through Chinese New Year but things feel like very different than they did last year, where there was a lot of disruption due to COVID. I think it's time for some of the people who've put off investments frankly to say, okay, now I need to make those investments. And our pivot to mass capacity are getting over to the same platform and everything allows us the flexibility to really go address the markets with high volume. So that's what underpins our confidence.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Okay, great. And then, Gianluca, you guys are doing sort of on the op margins, you're doing sort of the higher end of the range right now or in like sort of the upper 50%, upper half of the range. And it sounds like you're also talking about, a couple – a handful of things as we go through the year that can cause the gross margin to go up couple hundred basis points, 200, 300 basis points, I'm putting numbers on that. But I think you've had 200 basis points of COVID cost then you continue to get mix, you get pricing. But pricing feels a little bit more normalized right now on nearline drives, et cetera, et cetera.

So, what will you dig – does it mean, how do you think about the – I guess the normalized op margin range? If you're already sort of the upper 50% on the op margin range and you're going to capture 200, 300 bps on the

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gross margin, would you show that in a normalized fashion? Are there areas to go invest, I guess, that's really what I'm asking?

Gianluca Romano
Chief Financial Officer & Executive Vice President, Seagate Technology Plc
A

Yeah. Thank you, Ananda, and Happy New Year to you also. If you look at our performance before COVID, our operating margin was already at the top of the range. Now we were already at 16%, even it's a bit higher.

And then COVID happened and still happening. It's still impacting our results, but we are right now in the 15%. So we are going back to that level even with the COVID situation. So, of course, we expect fairly quickly. And based of course, on the impact from the COVID additional cost to go at the level that we were before the pandemic situation and even better.

And we are always looking internally at opportunity. We discussed a little bit the gross margin before. We are going in the right direction in terms of mix. We think now the industry pricing is also going in a better direction compared to, for example, a year ago. So all those elements are, of course, pointing to better gross margin, better operating margin, and I'm sure we will discuss this more at our Analyst Day.

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

Gianluca, that sounds like 18% to 20% operating margins to me, by the way?

Gianluca Romano
Chief Financial Officer & Executive Vice President, Seagate Technology Plc
A

I didn't say that.

Ananda Baruah
Analyst, Loop Capital Markets LLC
Q

Just saying. Thanks, guys. Appreciate.

Gianluca Romano
Chief Financial Officer & Executive Vice President, Seagate Technology Plc
A

Thank you.

Operator: Your next question comes from the line of Mehdi Hosseini with SIG. Your line is open.

Mehdi Hosseini
Analyst, Susquehanna International Group
Q

Yes. Thanks for taking my question. This is a follow-up to the prior question. It seems to me that you have made some changes to procuring subcomponents. And I want to see or get an idea of when those cost savings would actually materialize and help you with gross and operating margin? And I have a follow-up.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc
A

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Yeah, Mehdi. Thanks. We discussed the biggest impact for the gross margins was the COVID drivers and that's largely freight logistics-related, and the world has still got a lot of challenges on those on those fronts, and so I think a lot of people are feeling that.

Relative to components, I think we feel fairly solid about our components supply chain. So it was tough in the early days of COVID. We had to make sure that people had the right factories open and we had to get in there and work with all of our suppliers, especially the ones that are positioned for some of the products that are continuing to grow, that they're making the right investments in times that are pretty lean, but we're confident about how we did that. So I don't really – maybe bit to the earlier question, I don't really foresee any supply constraints, but it is forcing a different dialogue that we had, maybe to your – implied in your comments.

Mehdi Hosseini
Analyst, Susquehanna International Group

Q

Got you. And then looking at composition of a nearline, especially as you highlighted opportunities with video and surveillance, could there be increased diversification of nearline into both cloud service providers, as well as the like a surveillance, in other words surveillance moving into higher capacity, nearline and this way you get some diversification of end market demand drivers?

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

It's interesting because if you read the script, yeah, to the point about all these cameras generating all this data at the edge, and we expect that to be kind of a bellwether for a smart city, smart factory. There's a lot of data, some of it is video data, but there's other kinds of data being created at the edge.

A lot of that data today actually lies with the edge. It doesn't make it back up into the cloud. You start to see the nascent – the beginnings of models where people say, how do I get that data from the micro edge all the way back up to the core cloud? Because the cloud has some of the great applications to be able to process the data, you just have to physically get it there. I point to our Lyve product strategy for – that's exactly what we're thinking there.

And it's not small, the amount of data that's being created at the micro edge today and, like I said, either being overwritten or you have to make a decision once you process the data and you never get to make that decision ever again or never get to question that decision again. Things like autonomous vehicles, you want learning to go on so you need the data kind of resonant for quite some time. There's a lot of different models that are very, very interesting to us right now. And it is forcing a symbiosis, I guess that's the right word between micro edge and cloud, and the same kind of drives to service both. Yeah.

Mehdi Hosseini
Analyst, Susquehanna International Group

Q

Got it. Thank you.

Operator: Your next question comes from the line of Jim Suva with Citi Investment Research. Your line is open.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Thank you. And I just have one question. It seems like on both gross and operating margins, every indicator ahead whether it be pricing looks better, COVID costs are peaking, shipping costs are likely to get lower, new

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innovations rolling out are helping. Am I right to just simply put operating and gross margins should just continue to trend higher through 2021 or there's some actually negatives or headwinds that we should be mindful of as we go forward?

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

No headwinds, Jim. The world is still a fairly volatile place. Not everyone's through COVID, of course, and still impacting communities quite a bit. So from our perspective, we've narrowed down our product portfolio to have the right products, made sure our factories, our supply chains already talk to the customers and things like that. The story is coming out and we do believe there's data growth ahead, but we want to make sure that we're mindful of the realities and the economics today. That's why to our comments we think we're positioned really well, but we'll guide you quarter-over-quarter like we normally do.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Thank you so much for the details.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Thanks, Jim.

Operator: The final question comes from the line of Nikolay Todorov with Longbow Research. Your line is open.

Nikolay Todorov
Analyst, Longbow Research LLC

Q

Yes. Thanks, guys. Good afternoon. Thanks for squeezing me in. I just want to go back to the CapEx question and maybe try to get a little bit more color. Can you tell us a little bit more where do you see that supply and demand now fully balanced from your perspective? I have a guess, but I wanted to hear from you, and maybe can you try to quantify how much of a headwind is that under utilization to your profitability right now, whether on the gross margin line?

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah, Nikolay, thanks. It's a little bit of tough because if you think about what's the demand environment that we were in calendar year 2020 and how disruptive it was? You have some of the legacy products that were impacted quite a bit. Some of them are going back a little bit, some of them – that capacity can be repurposed back into mass capacity as well. And then mass capacity itself, the growth of the 18-terabyte drives, if you will, that requires what we call technology transition capacity, the dollars that we actually have to spend.

So, blending all these things together, the world is through this demand disruption, supply disruption period that we got through early last year. And what we're saying is we think that we can manage from here at the 4% to 5% range based on our modeling, and that'll be ample supply to be bringing online for what the demand is out there.

Nikolay Todorov
Analyst, Longbow Research LLC

Q

Okay. And the way to quantify the headwind, do you see a meaningful headwind from that underutilization or...

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William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Sorry, not really. Once the – maybe way back to Katy's question, once the factories fill up heads, media drive, I think that headwind will be gone, and so that that will happen here in a quarter or two.

Nikolay Todorov
Analyst, Longbow Research LLC

Q

Okay. Just a quick follow-up, on the legacy price per terabyte declining for a second quarter in a row double-digit year-over-year, I think over the last four or five quarters in the mid-single-digit, a lot more benign, I just want to – can you give us any color what drove that?

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

I think that's all about a mix. And segments, like consumer grow quite a bit, actually last quarter. So some of that work from home and play from home, the gaming, things like that. Mission-critical obviously was still recovering, but still light compared to what it had been previously, so I think that gets to the next part of that question.

Nikolay Todorov
Analyst, Longbow Research LLC

Q

Got it. Thanks, guys. Good luck.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

A

Thanks, Nikolay.

Operator: That concludes the question-and-answer session. I will turn the call back over to management.

William David Mosley
Chief Executive Officer & Director, Seagate Technology Plc

Thanks, David, and thank you to all of you for joining us today, and we look forward to speaking with you again as Gianluca said on our upcoming analysts day on February 24. Please join us there. I'd like to once again thank all of our customers, suppliers, business partners, and our employees for their ongoing support of Seagate. We'll talk to you next quarter.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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