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Seagate Technology Plc (STX)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, and welcome to the Seagate Technology Fiscal Third Quarter 2021 Financial Results Conference Call. My name is Gabriel, 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 March 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 and/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 June 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 and 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.

I'll now turn the call over to you, Dave.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

Thank you, Shanye. Welcome everyone and thanks for joining us today. Seagate delivered an outstanding March quarter executing well across multiple dimensions. We grew revenue quarter-over-quarter and year-over-year. We expanded non-GAAP operating margin into the recently increased target range and we achieved non-GAAP EPS above the high end of our guidance range. We also continued to drive forward on our commitment of advancing value for our shareholders, returning the combined $912 million during the March quarter through dividends and share repurchases. Fiscal year-to-date, we have repurchased approximately 12% of our common

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shares outstanding, a statement that demonstrates our confidence in Seagate's long-term business prospects. Gianluca will share more details on the financials shortly.

For the remainder of my remarks I'll focus on the business trends that we see unfolding this year, and how Seagate is well positioned from a product and technology perspective to unlock more value for our customers. Strong cloud data center demand and ongoing recovery in the enterprise markets drove our highest ever HDD shipments of 140 exabytes and record mass capacity revenue of more than $1.6 billion. These trends underscore the strong secular demand dynamics we are seeing in the mass capacity markets and support our outlook for the TAM to more than double by 2026 to roughly $26 billion. Cloud customers are helping drive this market expansion by investing in scale and infrastructure to support the acceleration in digital transformation of businesses worldwide as well as growing demand for AI and data analytics.

Seagate high capacity nearline drives are a vital component of these infrastructure investments. And we believe that our strong technology roadmap and focus around delivering the best total customer experience is helping drive broad adoption by the global cloud ecosystem. These factors were a driving force behind the number of new strategic partnerships and agreements formed last quarter with several of the world's leading cloud providers. These multi-year collaborations are focused on delivering innovative and reliable mass capacity storage at exabyte scale.

In the enterprise markets, we're seeing a continuation of the recovery trends that we discussed last quarter as businesses increase investments in traditional on-prem IT hardware. Recent CIO surveys highlight increased 2021 budget growth expectations to support their post-pandemic application and infrastructure needs.

We realized strong double-digit sequential revenue growth for both our enterprise nearline and mission critical products in the March quarter. And currently anticipate healthy demand through the calendar year. The record demand that I cited in the nearline markets more than offset anticipated seasonal declines for video and image applications. We see VIA market demand improving in the June quarter, and sustaining through the calendar year as planned smart city projects are slated to begin in the coming months.

Video analytics extends well beyond public safety. As I discussed at our recent analyst event, there's a growing list of edge applications that leverage video image sensors in areas such as retail, manufacturing and healthcare to derive valuable data insights. These applications support our longer term exabyte and revenue growth projections. Seagate is well positioned to benefit from these trends as we continue to lead the VIA market at all major capacity points driven by product areal density competitiveness and strong customer engagement.

Finally looking quickly at the legacy markets, higher enterprise mission critical sales and relatively stable desktop PC demand led to better than anticipated revenue in the March quarter, despite this period's typical seasonal slowdown. With a broader industry shift to mass capacity storage forming the foundation of our future revenue growth outlook, we've built a strong technology roadmap, streamlined product portfolio and are growing a pipeline of solutions and services that make us ideally suited to address big data demand now and well into the future.

Average capacity for drive increased 17% sequentially to top the 5 terabyte mark, a milestone that reflects the growth of mass capacity storage and demand for Seagate's high capacity nearline drives.

Today, Seagate is servicing the vast majority of market demand for 16 terabyte and higher capacity drives. We started to aggressively ramp 18 terabyte volume and current demand suggests strong sequential growth through at least the calendar year. We are also rapidly gaining traction with our industry leading MACH.2 dual actuator technology. MACH.2 has been proven to address TCO and performance requirements for certain applications

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with heavy data traffic, such as content streaming. We recently began the high volume ramp of MACH.2 drives with the leading hyperscale customer and plan to expand shipments to additional customers later in the calendar year.

And that brings me to HAMR. We believe HAMR is the technology to achieve drive capacities of 30 terabytes and beyond. Today, customers are testing 20 terabyte HAMR drives in their production environments which offers valuable feedback that we are factoring into our product roadmaps. I would highlight that through our innovation capabilities and our common platform approach, we have the flexibility to offer multiple versions of 20 terabyte drives to meet customer needs, not only with HAMR technology. We are focused on delivering solutions to customers that meet their roadmaps and lower their TCO and do so in a way that also drives value for Seagate. To that end, we plan to begin shipping a few versions of 20-terabyte drives in the second half of the calendar year.

This quarter, we introduced new key components of our Lyve edge-to-cloud platform. We launched Lyve Data Transfer enabling data movement on demand between the edge and the cloud. Lyve Data Transfer works seamlessly with Lyve Cloud, an object based storage as the service (sic) [storage-as-a-service] solution delivered in collaboration with Equinix and strategically located at the Metro Edge. In a recent survey conducted by IDC, a majority of respondents considered increasingly important to colocate data adjacent to applications or cloud services. We are progressing our build out plans and on track to have four Lyve cloud sites up by the end of the calendar year. We are gaining ecosystem support and have now been certified with each of the leading backup software vendors.

We're very excited about the future potential for Lyve products and services, which open a large and growing market opportunity for Seagate, estimated to reach about $50 billion by 2025. However, I do want to reiterate that we are still in the early innings. We're being deliberate in how we build out the platform and capabilities to position Seagate for long-term success. We are listening closely to customers to make sure we're designing and evolving our services to best serve their needs, particularly as the distributed enterprise itself evolves in the growing data sphere.

In the March quarter, we hit a milestone that took four decades to achieve. Seagate has now shipped a cumulative 3 zettabytes of HDD capacity, shipping over 3.3 billion disk drives. For perspective, at the 140 exabyte rate we shipped in the March quarter, we would ship our next 3 zettabytes in about five years. That is an amazing commentary on exploding global data sphere we live in today, and I think Seagate is in an outstanding position to drive great future value for our stakeholders.

I'll now hand the call over to Gianluca to cover details of our financial results.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Plc

Thank you, Dave. Seagate continued to execute exceptionally well as demonstrated by our strong March quarter performance. We delivered revenue of $2.73 billion, up 4% sequentially and above our guidance midpoint. We achieved non-GAAP gross margin of 27.4%, up 60 basis points sequentially. And we expanded non-GAAP operating margin to 15.4% inside the recently increased long-term target range of 15% to 20% of revenue. Strong demand for our mass capacity products supporting record hard disk drive capacity shipment of 140 exabyte, up 8% sequentially and 16% year-on-year. Nearly 80% of our total exabytes were shipped into the mass capacity markets, which include nearline, video and image application or VIA and NAS products. Mass capacity shipments increased to a record 111 exabytes in the March quarter, up 21% compared with March 2020, which was our prior shipment record.

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Based on our current outlook, exabyte shipment growth should continue through the calendar year consistent with our long-term CAGR forecast of about 35%. Ongoing demand for our high capacity nearline drive led to record mass capacity revenue of $1.6 billion, up 8% sequentially and up 5% compared with the prior year period. Mass capacity represented about 65% of total HDD revenue. Nearline revenue increased sharply quarter-over-quarter driven by strong recovery from enterprise and OEM customers as well as healthy growth from cloud. Nearline shipments were 95 exabytes, up 34% sequentially and 25% year-on-year. Average capacity per nearline drive increased to 12 terabytes driven by the strength of our high capacity drive. 16 terabytes and higher capacity contributed approximately 50% of our total March quarter's exabyte shipments.

Shipment trends in the VIA market are playing out much as we expected based on seasonality. Revenue declined sequentially in the March quarter from the record demand we saw in the December quarter. We are already seeing demand improve as some of the smart city projects that Dave mentioned take shape. We support our outlook for stronger VIA sales in the June quarter, and into the second half of the calendar year.

The legacy market made up 35% of March quarter HDD revenue. These markets adapt well in the seasonally slower period with revenue of $864 million, down 5% sequentially and 11% year-over-year. Improving demand for mission critical drives and stronger than anticipated demand for desktop PC partially offset anticipated decline in consumer drives. We shipped a total of 29 exabytes into the legacy market, down 9% on a sequential basis, reflecting the lower mix of consumer drives.

Looking ahead to the next few quarters, we expect the pace of year-on-year revenue decline to moderate, support a relatively stable demand for mission critical and consumer drives. Revenue from our non-HDD business increased 20% sequentially to $238 million, or 9% of March quarter revenue. The strong growth was driven by our system business as we began to ramp revenue from our customer win in the December quarter. We expect growth momentum to continue in our non-HDD business in the June quarter. In the March quarter, non-GAAP gross profit increased to $749 million compared with $704 million in the December quarter and included $24 million of COVID-related costs. We're currently planning to incur similar level of COVID-related costs throughout this calendar year, mainly driven by higher freight charges. Our resulting non-GAAP gross margin was 27.4%, including about 1% impact from these COVID-related costs. HDD margins expanded quarter-over-quarter driven by favorable mix offsetting the sequential growth of our non-HDD business which carries a lower gross margin profile.

Today, our mass capacity gross margin is already at the low end of our target range of 30% to 33% that we outlined at our recent analyst event. We are on track for total company gross margin to be in the low end of our new long-term range by the end of fiscal 2022, supported by the ongoing shift to mass capacity products, higher revenue contribution from cost optimized 2 terabyte per disk drive which make up less than 20% of revenue today, a gradual reduction in COVID-related cost and our continued focus on aligning supply with demand.

Non-GAAP operating expenses came in at $329 million, up $10 million sequentially. The increase reflects higher variable compensation associated with a strong performance and increased R&D material expenses to support new product development. Comparing with the same quarter last year, OpEx was down $11 million by supporting a slightly higher revenue level, demonstrating operational leverage and disciplined expense management.

Looking ahead, we expect operating expenses to be a bit higher in the June quarter as we gradually resume normal on-site business activities and travel. Our resulting non-GAAP operating income was $420 million and non-GAAP operating margin was 15.4% of revenue, up 70 basis points sequentially and inside our recently increased long-term target range of 15% to 20% of revenue.

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Based on the diluted share count of approximately 237 million shares, non-GAAP EPS for the March quarter was $1.48, up 16% sequentially and exceeded the high end of our guided range. The $0.18 outperformance relative to our guidance midpoint was driven mainly by higher revenue and operational leverage while our share repurchase activities enhanced EPS by $0.04. Capital expenditure were $104 million in the March quarter, which represented approximately 4% of revenue, and in line with our expectation for CapEx to be inside our long-term range of between 4% and 6% of revenue for the fiscal year. We will continue to focus on CapEx discipline to better align supply with demand through platform simplification and manufacturing efficiency improvement.

We had inventory relatively flat at $1.3 billion, consistent with our strong mass capacity storage demand outlook. Even the broader market dynamics and well-publicized component shortages were continuing to carry higher level of strategic inventory to protect against potential future supply chain risk as well as to help manage freight logistics. We believe these actions enable us to support customers' demand and we'll continue to monitor current market conditions. Days inventory outstanding reduced by 3 days sequentially to 59 days. We generated $274 million of free cash flow in the last quarter compared with $314 million in the December quarter and $260 million in the year ago period.

In the March quarter, we used $161 million to fund the dividend and $751 million to retire 11.3 million ordinary shares exiting the quarter with 230 million shares outstanding. Investment in Seagate share underscore our confidence in the long-term business strategy and future cash generation abilities. As a reminder, during the quarter, the board authorized an increase of $2 billion to our existing share repurchase authorization. As of the end of the quarter, we had $4.4 billion remaining in our authorization, subject to availability of distributable reserves. As we communicated at our recent analyst event, we expect to return more than 100% of free cash flow to shareholders in fiscal 2022. We will do this while maintaining a strong balance sheet and liquidity profile. Cash and cash equivalents were $1.2 billion and total liquidity was approximately $3 billion, including our revolving credit facility. These levers are more than adequate to support our operation and business needs.

Looking ahead to our outlook for the June quarter, we expect revenues to be in the range of $2.85 billion plus or minus $150 million, supported by continuous strength from cloud data center and enterprise customers along with increasing demand from VIA markets. We expect non-GAAP operating margin to be at the lower end of our new long-term target range of 15% to 20% of revenue. And we expect non-GAAP EPS to be in the range of $1.60 plus or minus $0.15 representing a sequential growth of 8% at midpoint. At the midpoint of our fourth quarter guidance range fiscal 2021 revenue would be $10.5 billion, flat year-on-year and aligned to the goal we set at the start for the fiscal year.

In closing, we continue to deliver on our financial commitment and remain on track to achieve the fiscal 2021 goals we have set while also demonstrating a clear path to meet the long-term objective outlined at our analyst event.

I will now turn the call back to Dave for final comments.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

Thanks Gianluca. In summary, we had a great quarter. Our growing mass capacity markets are showing strong demand and enterprise spending is in recovery. We are executing on our technology and product roadmaps and seeing positive customer engagement with our newest mass capacity offerings. We currently expect annual revenue growth of at least 10% in calendar year 2021 as the shift towards the less seasonal mass capacity markets supports a more stable revenue outlook through the year. We're also making deliberate steps to build out

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our Lyve platform, particularly Lyve Cloud and are excited by the early reaction from customers. All of this brings confidence to our positive outlook for the company and that confidence is illustrated by our active return of capital to our shareholders.

In recognition of Earth Day, it is fitting to highlight that we published our 15th Global Citizenship Annual Report this week. We are proud of our longstanding commitment to build sustainable supply chains and products to conserve the world's precious resources. In the most recent reporting period, we increased water recycling by nearly 9% and recycled the equivalent of 1,100 Olympic-size swimming pools. We reduced our production energy consumption by about 19% on a per exabyte basis. And we are executing plans to reduce our carbon footprint by 20% by 2025 and 60% by 2040 in accordance with science-based targets. Consistent with our core value of integrity, we will continue striving to balance our business decisions around people, our planet and profitability.

Prior to closing, I would like to thank our employees for their extraordinary efforts as well as our customers, suppliers and shareholders for their ongoing trust and support in Seagate.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] First question will come from Wamsi Mohan of Bank of America. Please go ahead.

Wamsi Mohan
Analyst, BofA Securities, Inc.

Q

Yes, thank you and congrats on the strong results. Could you maybe help us think about gross margins in terms of utilization rates across components and where you see the most room to improve? Appreciate the color you shared both around where you are with mass capacity and when you're getting to the low end of that long-term range. Maybe some color on the main factors that can cause you to achieve that level a little faster or maybe what would cause it to get pushed out would be helpful? And I have a follow-up.

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

A

Sure. Hi, Wamsi. I'll let Gianluca go through a couple details, but I'll just break it down real quickly. As we're going through the transition to the – on the [indiscernible] (00:24:07) common platform, we have the 16 to 18 terabyte and even beyond. We obviously control a lot of the internal components and we've said that we like the transitions for our ability to go control cost a little bit better as well, so that does help the margin. Probably the most important part of it relative to our manufacturing transactions is to transition as you said. Obviously gross margins are still very impacted by freight and logistics worldwide and even if customers want product immediately, we have – it's pretty expensive to go get it to them, so that's the other headwind that we have right now and we do see that some of that abating over the next six months. Go ahead Gianluca?

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

A

Well, I would say, first of all, we are very satisfied with the improvement in fiscal Q3. We improved by 60 basis points, is a fairly big jump in just one quarter. We are expecting further improvement. As we discussed at the Analyst Day, we have a clear target of 30% to 33% and that's few quarters from now. We communicated today

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that our mass capacity segment is already in that range, and it is also of course very important for us because, as you know, we have 65% of hard disk drive that is in that segment.

We need to look at the mix, for example, the non-hard disk part of the business has grown fairly materially in the last quarter. As you know that part of the business has a lower margin percentage but is a very good contributor to our free cash flow, so is a very important part of our business. I would say, for the future, as Dave said, one big element is COVID; the second big element is the continued transition to mass capacity. We expect a fairly strong quarter in June in the nearline part and a good recovery in surveillance. That is more seasonal than other parts of the mass capacity segment. So was down in March and we expect to recover in June. And then the continuous alignment between supply and demand. And as you know we are using our CapEx in order to, of course, increase capacity by increase in a way that is quarter after quarter align better to demand that is coming fairly strong. Regarding gross – well we've been guiding gross margin but you can extrapolate the gross margin for fiscal Q4. It has a slight improvement sequentially. I will say potentially we can do better than what is in the guidance and we need to go through the quarter, but I'm optimistic, I'm positive we'll have a good result.

Wamsi Mohan
Analyst, BofA Securities, Inc.

Q

No, that's great. I appreciate the color. And if I could, it's really interesting to see that the legacy exabytes have stabilized, and you called out the higher mission critical and desktop PC demand holding that up. When you think about the sustainability of that, frankly, I mean, as your – if you're right on OEM and on-prem demand increasing through the course of the year, and also desktop PC potentially going through a replacement cycle with the folks moving back into the offices, and even a stronger PC cycle in the second half of this year, would you say that there is actually an opportunity for legacy exabytes to grow meaningfully in the second half of the year? Thank you.

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

A

Yeah Wamsi, I would say that it's possible, but as you said strong demand in a lot of these segments, obviously long – over the long haul, we expect continued erosion, but most of the big erosion has already happened to your point, and so a lot of the systems that are out there certainly mission critical replacement rates and PCs that still exist, I think they're much more stable and to the extent that some of the recovery that happens after the pandemic in certain places in the world may actually drive needs for that kind of equipment, there may be a temporary run on that stuff, I think, is possible.

Wamsi Mohan
Analyst, BofA Securities, Inc.

Q

Thank you so much.

Operator: Our next question will come from Katy Huberty of Morgan Stanley. Please go ahead.

Kathryn Lynn Huberty
Analyst, Morgan Stanley & Co. LLC

Q

[indiscernible] (00:28:48) a couple questions. I think Dave you mentioned when you were talking about the mass capacity business and 18 terabyte that you would expect sequential growth through at least this calendar year, was that just for 18 terabyte or that was for mass capacity nearline in more broadly speaking?

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

A

Right, all of the above.

Kathryn Lynn Huberty
Analyst, Morgan Stanley & Co. LLC

Q

Okay, all of the above. And then what were the drivers of material upside in the non-HDD business this quarter and how should we think about the growth rate of that segment for calendar 2021?

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

A

Yeah, I think that there's some that is mass capacity, again, the systems business, for example, which is largely boxes full of mass capacity drives but to the extent that there's incremental revenue from the boxes – from the chassis themselves and the controllers that we use and things like that there's revenue in that and there's high demand for that as well, it's akin to mass capacity though. And then the consumer and the consumer SSD business doing quite well and strong demand. I think our brand is moving a lot of product there as well, so I think those are the big drivers there and it's a little bit aseasonal to your point.

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

A

We discussed last time of a good win is an important customer. And also now we are executing on that win. It will last also during the June quarter, so we expect good results also in the June quarter.

Kathryn Lynn Huberty
Analyst, Morgan Stanley & Co. LLC

Q

Okay. And then just lastly, I think I asked you last quarter about supply/demand dynamics and the potential for an improved pricing environment. There has been some more evidence that in some channels prices are increasing, some of the hyperscalers are talking about having to pay a little bit more for drives. How would you characterize the pricing environment, both that you saw in the March quarter, but also what you expect over the next couple of quarters?

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

A

I think as you know we have long cycle times and so therefore, we have long planning cycles with most of the big scale customers and so I think the things on that front are fairly predictable. Everyone's going through certain kinds of component shortages. I think that may actually – it doesn't really affect our supply, but it may actually affect the end demand based on what everybody can get and kit together and things like that. So, I think it's a relatively benign environment from that perspective.

There are interesting trends that are going on out in the world about what people are doing with mass capacity storage. I think there is a lot of innovation vectors that are taking off and especially as recovery happens. And these are things that we're watching and I think if you look through the distribution channels, you'll see fairly strong demand for that as well. Again, it's mass capacity demand, but some of the file sharing platforms that exist out there, IPFS is one that we're watching really carefully. It's an interesting dynamic with a lot of kind of vibrancy, the kind that I just love to see lot of creative professionals just coming up with new types of applications and these

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are driving demand as well. So, I think that's probably something you see if you look at those channels in particular.

Kathryn Lynn Huberty
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Great. Thank you.

Operator: And your next question will come from Aaron Rakers with Wells Fargo. Please go ahead.

Aaron Rakers
Analyst, Wells Fargo Securities LLC

Q

Yeah. Thanks for taking the question. I believe and I want to make sure I didn't hear incorrectly that, Dave at the end of your prepared remarks you'd commented that you expect to see at least 10% year-over-year growth in calendar 2021. Can you just help us understand or appreciate how that has changed that – first of all, is that correct, and secondly, how has your outlook kind of changed, what's been the drivers of that change over the course of the last three months or so?

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

A

Yeah. Thanks Aaron. So obviously looking back at 2020, there was supply and demand disruption. So at first when the supply was disrupted people were shutting down factories, there was a lot of pull-in of demand. And then the demand realities in about July timeframe came to roost, right. So that – so we lived through that in 2020. I think 2021 there is still some kind of supply concerns that people have about components everywhere and so there are people pulling things in. From my perspective mass capacity is relatively insulated from some of that and we have pretty predictable relationships exactly to Katy's question. So, we look at this year as not having as profound an impact as we did in 2020 and that's where we get the 10% and it's largely on the strength of mass capacity, some of the VIA markets and things like that will be contributing as well but it's largely the cloud and enterprise on-prem coming back.

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

A

Yeah, and we've said two things, we said at least 10% and we also said that we expect revenue to be maybe more stable throughout the quarter. So, we don't expect a lot of seasonality and I think that is important when you model your quarters out.

Aaron Rakers
Analyst, Wells Fargo Securities LLC

Q

Yeah, that's helpful. And then just as a real quick follow-up or second question is, on the gross margin trajectory you've now got, I think, 65% of your revenue coming from mass capacity. You had talked about that business now running at the low end of that 30% to 33% guidance long-term target model. How do you think about that longer term? Do you think actually that mass capacity gross margin can trend up at the high end or even above the high end on that long-term model range that you've outlined? Thank you.

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

A

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Yeah, simply put, yes. I think we have to get our – all of our manufacturing capacity pointed in the right direction there and as legacy comes down that helps us. And then there's other opportunities as well like platform commonality and things like that. And we've kind of said that 16 terabyte was getting a little long in the tooth, that's why we want to accelerate into 18 terabytes and the 20 terabytes, and in each one of those points you get a chance to refresh and maybe take some cost out as well, based on what new designs are in the factory. So – but we get the leverage of the platform too so, if that helps you.

Aaron Rakers
Analyst, Wells Fargo Securities LLC

Q

Yeah. Thank you.

Operator: Your next question will come from Karl Ackerman of Cowen. Please go ahead.

Karl Ackerman
Analyst, Cowen & Co. LLC

Q

Yes, Good afternoon. Dave or Gianluca you – I guess Dave you referenced this in an earlier question. In recent days, there have been reports of some significant price hikes in the retail aftermarket as hard drives are being used for new applications like cryptomining. While you have less control over the retail market from a pricing perspective, I was hoping you could discuss how demand in the channel maybe impacting your factory utilization and lead times across your customer base?

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

A

Yeah, I would say that we always budget enough capacity for the channel. I mean channels – the customers in the channel are varied and important to us. And – so we always budget enough capacity to make sure that we're servicing the channels well. We do see the uptick in demand that you're referring to. Like we said, we're watching the different trends that are causing it. Some of them are really interesting vibrant trends. And we love that. What I would say is that it's a little early in this – to know how prolong it is – how prolonged it will be. So I think we're even early in this quarter, so it's really hard to know exactly what the distribution channel reaction's going to be. And I also think that getting people things immediately is a problem in the world today because – so back to your question about the manufacturing capacity we have, even if we – even if it came out of the back of our factory, getting it around the world to that channel location might be a problem, right? So I think we'll have to look at all these dynamics, look at the lag or lead times if you will, on how that demand's developing and to figure out how we'll service it.

Karl Ackerman
Analyst, Cowen & Co. LLC

Q

Understood. If I may, just while on the topic of cryptocurrency, I could be wrong, but I believe you still maintain your stake in Ripple, it has over the last few years and that's appreciated 5x since you last reported. So I guess, A, do you still maintain the stake there and then secondarily are there ways to monetize that stake today? Thank you.

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

A

Yeah. We won't talk about the latter part. But yes, we do maintain a stake. These are, like I said, vibrant segments that we've been watching for quite some time. We have fair amount of people that are – because it's all about

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data flow and in the case of the recent trends a lot of its about data storage in particular, so these are things that we watch and determine how we make investments not only in external investments that we might make, but also internally, what kind of technologies we're developing. So, we are maintaining a stake.

Karl Ackerman
Analyst, Cowen & Co. LLC

Q

Thank you.

Operator: Your next question will come from Thomas O'Malley of Barclays. Please go ahead.

Thomas O'Malley
Analyst, Barclays

Q

Hey, guys. Nice results and thanks for taking my question. Mine was really related to the VIA market. On the last earnings call, I think Dave you described environment that was down mid-teens in terms of revenue and at least with exabytes that you guys break out, you saw it down like in the 40% range. Should you see some of that snapback more violently in the June quarter given how hard it fell off in March? And just could you walk through what are the reasons why you saw it down so hard in March and why should it come back in June? Thank you.

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

A

Yeah. This is typically – I'll let Gianluca answer partly as well but this is typically a seasonal market and it's tied to I'll say government spending and build out. Now obviously a lot of that has been disrupted at various places in the world right now. And then I think if you go back four quarters ago, the edge markets were generally really depressed, because I think my comment at the time was nobody's on-prem anyway. So, people just aren't making on-prem. So, I think there's been high degree of cyclicality this year to the point. I think what we're seeing right now is not only a replenishment of the supply chains that were disturbed but also an early in the year investment cycle in smart city applications and some of that may be because of healthcare data or maybe because of buildings reopening and they hadn't been making investments for a while, but it seems to be relatively earlier and maybe aseasonal right now. Gianluca?

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

A

Yeah, inside the mass capacity segment, VIA is probably the only one that is seasonal. So, it is not unexpected, we knew that into the March quarter we were going to have a decline. As I said before, June quarter will start to be a much stronger quarter for VIA and will continue to decrease in the September and December. Usually December is a stronger quarter for VIA.

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

A

And sorry one other point too. Our central thesis is that the data at the extreme edge is not being properly utilized. As a matter of fact, it – a lot of times this gets deleted and we think there are people who are starting to answer questions about how do I store that for a little bit longer and then process the data with AI or ML and make value-based decisions on the data, maybe not necessarily in the next minute, but maybe a day later or week later. And so as that happens, we expect some of this seasonality to be more muted over time.

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Thomas O'Malley
Analyst, Barclays

Q

Great. That's helpful. And then my follow-up was really around nearline. Obviously you guys don't like to talk about share, but let's just look at exabytes. If you look at what the market was forecasting for March, I mean you have 50-plus-percent share of that market. A better way to ask you other than share is could you talk about the dialogues that you're having with customers with nearline drives? What kind of success are you seeing over the next couple of quarters and what kind of led you to the position where you are right now where you're maintaining this higher percentage of share? You can answer that however you want but I just wanted to dive in there.

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

A

Yeah, it's great. I mean I don't really think about it as share because to your point, we go out to the customers we have since the lead times on the products are so long, we have good dialogues about not what do you need in six weeks, but what do you need in six months. And I think that's working quite well. Our customers appreciate that we still have flexibility for them, but we're kind of co-planning in that respect and I think that served us both – very well on both ends.

So, the bouncing ball on share if you will, I don't have a great visibility into how that's going to change. I just know what our demand is and that's what I said. I do think there's a little element in the last few quarters of, at the end of quarters sometimes Seagate gets pulled a little harder than we thought and that may be a competitive dynamic or it may just be the customers were holding a little bit in their back pocket, but in general it's become a way more stable environment than it used to be, and we're not building things speculatively either. We have been starting our 18 terabyte ramp has been – we were ready for that drive mid last summer. The customers weren't really ready so we've been going up a very predictable ramp for that and keeping our factories full with the 16-terabyte, while that was happening and having good dialogues too. So, I think that's serving us well. We're not in the era of building – having a hunch, building a bunch and then speculatively trying to move in at the last minute anymore.

Thomas O'Malley
Analyst, Barclays

Q

Okay, thanks Dave.

Operator: Next question will come from Ananda Baruah of Loop. Please go ahead.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Hey, thanks guys for taking the question. Appreciate it. Yeah, congrats on solid results and good execution. Just two quick ones, if I could. Both are kind of clarifications. Dave just sort of going back to pricing, you said that things are fairly benign. I guess, did that mean that there – really just trying to understand [indiscernible] (00:43:42) opportunity for pricing to improve as we go through the year relative to maybe what you thought 90 days ago? And I just wanted to get your thoughts there and see if I lost anything in translation and then I have a quick follow-up?

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

A

I think well into the 90 day...

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Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

[indiscernible] (00:44:01), yeah and really...

[indiscernible] (00:44:03)

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Yeah, sorry Dave. Nearline pricing specifically.

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

A

Yeah, I would say relative to 90 days ago, I mean, again, we've been fairly predictable in giving our customers what they need and – to the extent that that's locked in with our manufacturing capacity, not much has changed on our front. I do think across the broader world, procurement people tend to be even more concerned about supply. And so some of the discussions are being even more mature than we had thought 90 days ago. That's the way I think about it. And we made reference to this in the prepared remarks about some of the long-term agreements that we've been able to establish in the last quarter.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Got it. And so the LCAs I mean, is it useful for us to think about they are used in an increasingly structural sense, kind of, à la 2012 which was an extreme case, but it was sort of material to financial impact. Is it useful at all to think about it in a structural sense like that or is this more on the margin?

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

A

I think that was much more profound back then. From my perspective, supply and demand is a lot more imbalanced then back in those days. As a matter of fact supply was so disrupted last year and demand was disrupted as well that we're still feeling the reverb, but it's very different than the 2012 environment. I would say that the biggest difference is the lead times on the products, I mean the wafer starts that we're doing right now realistically are hitting – for the mass capacity drives are hitting the backend of our testers, probably around Christmas. And if you think about that that's driving really good healthy discussions with what people exactly need and what kind of flexibility they need.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Got it. That's helpful context. I appreciate it. That's it for me. Thanks a lot.

Operator: Next question will come from Mehdi Hosseini of SIG. Please go ahead.

Mehdi Hosseini
Analyst, Susquehanna International Group

Q

Yes. Thanks for taking my question. Two follow-ups. I believe in – you guided to nearline exabyte growth of 35%, is that correct? Did I hear that right?

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

Yeah. That's right, Mehdi. That's right. That's what we've been saying 35%. It's been a little bit stronger from that for the last couple of years for us, but that's what we think the long-term growth rate is 35% to 40%.

Mehdi Hosseini
Analyst, Susquehanna International Group
Q

Sure. And it seems to me maybe you're a little bit more on a conservative side and I say that because if I just take – make certain assumption for the June quarter, that would imply the acceleration into the back half of the year – like in second half of the calendar year to get to that 35%?

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

I think we do think that mass capacity is going to continue to grow. Yeah, I think we've talked about this a little bit. The cloud service providers around the world have to make tough decisions on exactly how they're making investments and so not all of those investments are necessarily mass capacity related. But we do expect a continued growth in mass capacity into the back half of the year and that's when Gianluca made the comment earlier about aseasonality, that's what he was talking about.

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

Yes, that is an important point. We see strong cloud and enterprise OEM but you also need to consider the sequential improvement in surveillance and in the VIA market in general that is increasing in volume and in revenue through the calendar year.

Mehdi Hosseini
Analyst, Susquehanna International Group
Q

Got it. And just to be clear, you're referencing year-over-year growth or sequential growth?

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

Well, in the remarks we said 10% is year-over-year. Of course, the surveillance comment is sequential, so depending if you are looking at the second half of the calendar year compared to the first half or you're just comparing year-over-year.

Mehdi Hosseini
Analyst, Susquehanna International Group
Q

Sure. Got it. And just very quickly as a follow-up to your 20 terabyte commentary that you're going to have several different products and especially in the context of lower CapEx, is this going to basically enable you to extend your market share from 18 to 20 terabyte especially it seems to me that HAMR may have been pushed out, so now you have alternative technology, is that how we should think about it?

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

Yeah, I don't really think about it as market share, I think more about as what customers want, what technology portfolio that we have and how we might service them. And I think it's important to remember that the cloud, if you

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will, – mass capacity is not one size fits all, there are many different types of firmware load outs, applications that are – that require different performance levels, that can tolerate different performance levels. Some are colder storage and some are very much nearline, right, so they're very active 24/7. So there are going to be multiple flavors of the technology. It's all serviced off the same common platform. And from my perspective, I think we're locked in pretty tight with customers that's why we've got confidence and when I say multiple flavors, that doesn't mean one or two.

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

Thanks, Mehdi.

Mehdi Hosseini
Analyst, Susquehanna International Group
Q

Thank you.

Operator: And your next question will come from Patrick Ho of Stifel. Please go ahead.

Patrick J Ho
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Very nice quarter. Maybe Dave first off, it's good to hear some of the commentary about your 18 terabytes growing through the rest of this year. Can you just give a little qualitative color whether you're getting that 18 terabyte demand from co-existing customers at lower capacity points or are they from potential new customers that hadn't used Seagate over the last few capacity points?

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

No, maybe the way I would characterize it is, there are some customers that were using 16-terabyte that are transitioning, but there are also other customers that were not transitioning from previous 12-terabyte or 14-terabyte or wherever they were before. And I think we have fairly broad representation. I do think the markets are generally moving up from like I said back – if I think back to the 6 or 8 terabyte days, people would be stuck on some of those lower capacity points much longer. In general, people who are doing data center build outs around the world are using that mass capacity leading edge drive much more aggressively. So from my perspective, the 18 terabyte is very broad adoption, and I have already said, we like the platform quite a bit because we're continuing to get cost leverage out of it, so...

Patrick J Ho
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Great. And maybe as my follow-up question is for Gianluca. You've given really good color in terms of the gross margin level and what's driving that. Can you give a little color of some of the OpEx levers, what's driving that? Are you adding more head count with the increasing demand, what are some of the moving pieces there?

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

Yeah, so the OpEx year-on-year was about $10 million lower, sequentially was a little bit higher. The increase sequentially is basically due to variable compensation and little bit higher R&D material spending. We said a

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couple of quarters ago that we expect our normal trend to be around $340 million per quarter, so we are very well-aligned to that expectation, and we think that probably will be our level in the next couple of quarters.

Patrick J Ho
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Thank you.

Operator: Your next question will come from Shannon Cross with Cross Research. Please go ahead.

Shannon Cross
Analyst, Cross Research

Q

Thank you. Earlier you talked about challenges of shipping into the retail channel, but I'm wondering if you could speak to how the current supply channel issues are impacting other segments of your business and how you sort of incorporated them into the model? And I have a follow-up. Thank you.

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

A

Yeah, again – sorry Shannon. So, not so much on the supplier parts for us, although, I think everybody's watching the same kinds of long-term supply issues, but short-term, we hear from customers that they're having problems getting the final kit. And so usually what that does to us is it makes – it may mean that in order to hit that revenue or secure that customer win for them, they may need it differently and so where you're having to happen to be very flexible.

Shannon Cross
Analyst, Cross Research

Q

So do you see it basically just pushing out demand though, right, as opposed to taking any away from a long-term perspective?

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

A

Yeah, I think – exactly to your point, I mean I think the demand is there, it's just how exactly quickly it can be served and then obviously some customers if they can't serve it, somebody else will and so there is a lot of those dynamics out in the world right now.

Shannon Cross
Analyst, Cross Research

Q

Right. And then my second question and I realize it's new, but you mentioned you've had some positive feedback on Lyve Cloud. I was wondering which segments are seeing the most interest and maybe if you can give a little more color on what you're hearing from the customers? Thanks.

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

A

Sure. I think – if you think about Lyve Cloud as almost like an external storage or an external hard drive in the cloud, sort of, the comments you made about retail. It's very simple. There's no ingress or egress fees. There's – it's a scratchpad that's the way I think about it and you can use it temporarily, you can use it permanently if you want. I think there are customers who are very – who are always aggregating data out of certain locations and

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want a temporary landing spot before they find out exactly where they're going to put their data long-term and so these are the kinds of customers that are giving us a lot of interesting feedbacks for us to do continued development of the thing and it's – we're not talking 5 terabytes at a time, this is people that have 10s of petabytes or even bigger.

Shannon Cross
Analyst, Cross Research

Q

Great. Thank you.

Operator: And your next question will come from Sidney Ho of Deutsche Bank. Please go ahead.

Sidney Ho
Analyst, Deutsche Bank Securities, Inc.

Q

I have two. The first question is, Dave, you talk about the 10% – at least 10% revenue growth for calendar 2021. If my math is right, that would imply the average revenue for calendar Q3 and calendar Q4 will be consistent or maybe slightly below calendar Q2. I always had thought the numbers could go – could keep going up on a sequential basis based on all the recovery you're seeing. I know you said at least 10%, but are there some things that we should consider here?

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

A

Sorry, Gianluca wants to answer it.

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

A

Yeah, of course, we don't guide the individual quarters. I think it's fairly easy for you to calculate that – at least 10%. We didn't say how much more than 10%, we said at least 10% for the calendar year. And then we will discuss the following quarters during the next earning release. We have said driving to be very strong in the calendar year, so just please wait for a few more months and get more details on the individual quarter.

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

A

But Sidney, I would say that what we are trying to say is that, I think things are relatively full and we expect a sort of muted seasonality if you will as we look forward, that's definitely true.

Sidney Ho
Analyst, Deutsche Bank Securities, Inc.

Q

Okay, that's helpful. Maybe my follow-up question is really to the 20 terabytes drives. I know you started shipping the HAMR drives back in November and you seem to think that the PMR is expandable through at least 20 terabytes. And you talked about having multiple products at that capacity come out of the second half? I would think qualifying multiple products at the same capacity point will increase the cost of your customers. Does it not make sense to say, at a certain capacity point you only offer one type of technology or are there other things that we should think about that may mitigate that?

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

A

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Yeah, it's interesting. There are different types of customers who want different performance levels. I think I made reference to that earlier, but to the extent that we already know the heads and media and this platform family really well and we don't have to turn the heads and media, that's one option. Another option is various flavors of SMR like we talked about. So there's lots of different ways to provide those customer solutions. Is it more complex for us? Yes. But we have this common platform, and so that common platform can go multiple different directions and we feel very confident in that and we're not really worried about qualifications or anything like that.

Sidney Ho
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thank you.

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

A

Thanks.

Operator: And we have time for one final question from Steven Fox of Fox Advisors. Please go ahead.

Steven B. Fox
Analyst, Fox Advisors LLC

Q

Hi, good afternoon. Thanks for squeezing me in. Two, kind of clarifications. First of all, on the video side, in terms of the recovery, I'm not sure if I understood that it's mainly surveillance still or were you – Dave, were you trying to imply that you're also seeing some of these other edge use cases really take off or if not now, can you maybe talk about when? And then secondly, as you buy ahead on components, I understand building the safety stock, but given how the supply chain is changing, do you see that sort of delta increasing, decreasing, staying the same versus your actual needs? Thanks.

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

A

Yeah, I think there are lot of question first. We do – we have long lead times for our components internally, you got to run the factories every day, 91 days a quarter or so to the extent that we know exactly what we want for this common platform and for all the other products that we're building. I think we do make sure that we have enough stock for whatever contingencies we have.

From my perspective on the smart city applications that we're seeing, they are very – it's not just – this is not just a surveillance market anymore so to speak. There are many different types of edge use cases that are starting to develop. And even the – even some of the building security types of applications are – they have a lot more features that are being demanded of them now, so they're not just the same kind of security we're all used to, there's other kinds of features being put in and so therefore if you're buying the solution for a facility or you're upgrading a facility, you want all those new features. I think that's actually driving demand for higher capacity storage as well. So – and then sorry Steve, what we said earlier was, last year was so disrupted from a supply/demand perspective on this front, people were investing in the edge, I think that's why we're seeing this kind of pulling in of the market this year relatively.

Steven B. Fox
Analyst, Fox Advisors LLC

Q

Got it. It's very helpful. Thank you.

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Operator: And it's all the time we have. I'll now turn the call back over to the presenters for some closing remarks.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

Well, thanks, Gabriel. And thanks to all of you for joining us today. Seagate continues to execute well and remains excited about the tremendous opportunities we foresee ahead both in the near term and longer term driven by a massive growth in data. I'd like to once again thank our customers, suppliers, business partners and importantly our employees for their ongoing support to Seagate.

Operator: This concludes today's conference call. Thank you for joining. You may now disconnect.

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