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Seagate Technology Holdings Plc (STX)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Seagate Technology Fiscal Second Quarter 2024 Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Shanye Hudson, Senior Vice President, Investor Relations. Please go ahead.

Shanye Hudson

Senior Vice President-Investor Relations and Finance Strategy, Seagate Technology Holdings Plc

Thank you. Hello, 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 posted our earnings press release and the detailed supplemental information for our December quarter results 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 included in our Form 8-K. We have 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.

Before we begin, I'd like to remind you that today's call contains forward-looking statements that reflect management's current views and assumptions based on the information available to us as of today, and should not be relied upon as of any subsequent date. Actual results may differ materially from those contained in or implied by these forward-looking statements, as they're subject to risks and uncertainties associated with our business.

To learn more about the risks, uncertainties and other factors that may affect our future business results, please refer to the press release issued today and our SEC filings, including our most recent annual report on Form 10-K and quarterly report on Form 10-Q, as well as the supplemental information, all of which may be found in 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 Dave for his opening remarks.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Thanks, Shanye, and hello, everyone. I am going to focus on two key topics in my remarks today. First, we delivered solid fiscal second quarter results, with revenue at the midpoint of our guidance, and non-GAAP earnings of \$0.12 per share, exceeding the upper end of our guided range. And second, last week, we marked a major inflection point in mass capacity storage with the launch of our groundbreaking Mozaic platform.

Mozaic is intentionally named to describe the fusion of innovative technologies, including Seagate's unique implementation of HAMR, that collectively enable us to extend our areal density leadership. As we shared in the

past, growing areal density is the most efficient way to enable data center operators to scale mass capacity storage to lower their TCO and to advance their sustainability targets.

I'll discuss the platform in more detail shortly and also share progress towards qualification and volume ramp of our first HAMR-based Mozaic product, which lays the foundation for products boasting 5 terabytes per disk and beyond.

Let me start by highlighting our fiscal Q2 performance. Revenue of \$1.56 billion was led by sequentially improving cloud nearline demand and a seasonal uptick in consumer drives, offset partially by the decline in VIA sales that we anticipated. Strong cost discipline and execution on pricing adjustments resulted in non-GAAP operating income tripling quarter-over-quarter and increasing roughly 17% year-over-year, despite lower revenue levels. These performance and demand trends affirm our expectation for the September quarter to be the bottom of this prolonged downcycle.

The enhanced discipline we've built into the business, including strict cost controls, management of supply and strengthening of our balance sheet, gives us an excellent foundation to build on as we move into a broader recovery. Additionally, execution of our product roadmap is expected to structurally improve profitability and return us to our targeted financial model, which supports healthier industry economics. We enter calendar 2024 with increased confidence in our non-GAAP gross margin trajectory, including our ability to reclaim 30% minimum benchmark level at quarterly revenues that are at least 20% below our prior cyclical peak.

From a demand standpoint, gradual recovery within the US cloud market has started to take shape, reflecting solid progress in consuming excess inventory, along with more stable end market behavior. Enterprise OEM demand trends have also stabilized within the US markets. Customer feedback still points to macro-related concerns, although IT hardware budgets are projected to modestly improve in calendar 2024 and traditional server growth expected to resume, trends that support incremental HDD demand growth in the calendar year.

We were also encouraged to see incremental demand amongst certain non-US cloud and enterprise customers in the December quarter. Across the broader China markets, we project a relatively slower pace of recovery, given the ongoing economic challenges within the region. However, some local governments announced further steps to support the region's economy, which our customers believe will bolster local demand across mass capacity markets in China in the second half of the calendar year. These efforts support our view for demand in the VIA markets to pick up sometime after the Lunar New Year.

Against the dynamic market environment, Seagate has continued to execute on a mass capacity product portfolio that further advances our technology leadership and serves the breadth of our customers' unique workload requirements while also supporting our objective of improving profitability. I'll outline the execution path for our latest product launches and the relevance of the new platform, and then share how we believe our mass capacity solutions deliver economic value both to our customers and to Seagate.

Our product qualification and ramp plans are on track with what we've been articulating over the past several quarters. We began shipping initial volumes of our 24-terabyte CMR, 28-terabyte SMR drives in the December quarter. Customer reception has been positive, as illustrated by the numerous active qualifications underway across multiple cloud and enterprise customers.

Our 3-plus terabyte per disk product is the first major release of the HAMR-based Mozaic platform, and we are rapidly nearing qual completion with our initial hyperscale launch partner. The qual has gone very well, and we

are working with this customer at their request to fully transition future Seagate demand to the 3-plus terabyte per disk platform.

Volume ramp is starting in the March quarter according to plan, with a goal to ship about 1 million units in the first half of this calendar year. We then expect to continue to ramp through the balance of the calendar year, and we are currently broadening our customer engagements. Based on their planned timelines, we expect to complete qualifications with a majority of US hyperscalers and a couple global cloud customers during calendar 2024.

Starting at 3 terabytes per disk, Mozaic delivers a quantum leap forward in areal density innovation, with a well-defined path that extends to 5 terabytes per disk and beyond. This transformative platform is the culmination of decades of development and numerous technologies pioneered by Seagate, including our superlattice platinum-alloy media that enables higher bit density, and the revolutionary plasmonic writer with integrated laser, capable of reliability writing each bit, and an advanced reader technology that boast one of the world's smallest reading sensors.

While Mozaic represents groundbreaking technology, the platform is fully plug-and-play with existing conventional drives and addresses the breadth of our customers' mass capacity workloads. These drives can also be deployed with SMR technologies for the few customers able to integrate SMR to take advantage of the additional capacity gains. As I noted earlier, areal density gains are the most efficient way to scale storage capacity.

Let me offer a few clear examples. First, as we execute our product roadmap, we can deliver increasingly higher capacity drives with minimal changes to the bill of materials. This results in a better TCO value proposition for our customers and attractive economics for Seagate.

Second, as we scale areal density to 4 terabytes per disk, this enables extremely cost-effective product offerings in the low- to mid-range capacity points used by a majority of our enterprise VIA NAS customers. With 4 terabytes per disk, we used half the number of heads and disks to produce a 20-terabyte drive. Prototypes are already working in our labs, with revenue planned for the second half of calendar 2025.

As we ramp production to expand to other end markets, we gained tremendous manufacturing efficiencies, adding to the attractive margin opportunities that I just described. We continue to build on our technology and operational innovations with each successive product generation. For example, we are executing plans to vertically integrate the laser manufacturing process, which enhances supply flexibility, provides greater control of the technology, and provides opportunities to lower production costs. Collectively, we believe these actions underpin our mass capacity cost reduction roadmap, while also providing a very strong TCO story for a broad range of customers.

While TCO remains a key driver for mass capacity storage, data center operators are also focused on power and space consumption, particularly as investments in compute-intensive infrastructure proliferates to support generative AI applications. For context, the latest AI GPUs consume up to 700 watts, which is roughly 100 times more power-intensive than a hard drive operating at maximum performance.

Our products can help data center operators store more exabytes using less power and space. To quantify this, a single 32-terabyte Mozaic drive can replace three 10-terabyte drives, storing more capacity at one-third of the power and footprint. TCO and sustainability gains of this magnitude are decision-altering when architecting a new data center and offer a highly economical path to modernizing existing infrastructure. We believe that this dynamic can potentially accelerate the replacement cycle.

As we move into the early stages of demand recovery, Seagate's strong focus on maintaining our product and technology roadmap through this past downcycle position us to return to profitable growth and address data center operators' most important challenges: cost, power and space. We believe we've got the right product at the right time, heading into a gradual recovering mass capacity market.

With that, Gianluca will now cover details on our financial performance and outlook.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

Thank you, Dave. Seagate's December quarter financial results reflect solid operational execution. Revenue was \$1.56 billion, up 7% quarter-over-quarter. Non-GAAP operating income more than tripled sequentially to \$127 million, leading to non-GAAP operating margin expanding to 8.2% of revenue, up 540 basis points quarter-over-quarter. And non-GAAP EPS was \$0.12, improving \$0.34 sequentially and exceeding the high end of our original guidance range, reflecting both improving demand trends and our focus on profitability. As these trends continue, we expect our results to improve and reach the target financial model over time.

Within our hard disk drive business, exabyte shipments grew 6% sequentially to 95, with revenue growing 7% to \$1.4 billion. Revenue performance was mainly driven by the expected improvement in cloud customer demand, along with seasonal improvement in the consumer market.

Within the mass capacity market, revenue increased 4% sequentially to \$1.1 billion, driven mainly by strong nearline cloud demand, offsetting the expected decline in the VIA market. Mass capacity shipments totaled 83 exabytes compared with 79 exabytes in the September quarter. Mass capacity shipments as a percent of total HDD exabyte was 87%, which is comparable to the prior quarter 88%.

For nearline products, shipment of 65 exabytes were up quarter-over-quarter from 56 exabytes. Average capacity per nearline drive continued to increase sequentially, reflecting modest demand improvement among both US cloud customer and China cloud customers. We believe that inventory among many CSP customers is reaching more normalized levels and anticipate continued nearline demand improvement in the March quarter and beyond.

VIA market revenue was down sequentially in the December quarter, consistent with our expectations. Looking ahead, we expect VIA to reflect more typical seasonal patterns through calendar 2024, with the March quarter representing the low point.

Legacy product revenue was \$324 million, up from \$278 million in the prior quarter, driven by higher seasonal demand in the consumer market. We expect the legacy market to be sequentially lower in the March quarter, following typical consumer demand trends post-holiday season. Finally, revenue for our non-HDD business increased to \$171 million compared with \$159 million last quarter, primarily driven by improved SSD demand.

Moving on to the rest of the income statement, non-GAAP gross profit increased sequentially by roughly \$80 million in the December quarter to \$367 million, ahead of our original expectations. Non-GAAP gross margin of 23.6% expanded nearly 400 basis points compared to the previous quarter, due in part to pricing adjustment and cost saving from earlier restructuring activities, as well as lower amortization costs, which were about \$40 million, consistent with our view for ongoing demand recovery. However, we expect underutilization costs to margin increase for the next couple of quarters, as we transition some of our production line to Mozaic.

Accounting for this headwind, we still expect to see margin expansion every quarter in calendar 2024, as nearline demand continue to improve gradually and we ramp our latest products along with continued execution of price adjustment across the entire portfolio.

Non-GAAP operating expenses totaled \$240 million, down from \$248 million in the September quarter and reflecting ongoing spending optimization. With the benefit of diligent expense management and higher margins, adjusted EBITDA improved more than 50% sequentially to \$216 million. Non-GAAP net income turned positive in the December quarter, resulting in non-GAAP EPS of \$0.12 per share, based on diluted share count of approximately 211 million shares and tax expense of \$17 million.

Moving on to cash flow and the balance sheet, in the December quarter, we had inventory flat, at just below \$1.1 billion. Capital expenditure were also flat sequentially at \$70 million. A majority of planned capital expenditure were completed in the first half of fiscal 2024. Consistent with prior commentary, we still expect fiscal 2024 CapEx to be down significantly compared with fiscal 2023, although still sufficient to support our innovation-driven product roadmap. We generated about \$100 million in free cash flow and returned \$146 million to shareholders through the quarterly dividend, exiting the quarter with 210 million shares outstanding.

We closed the December quarter with \$2.3 billion in available liquidity, including our undrawn revolving credit facility. Our debt balance was \$5.7 billion at the end of December quarter, with more than 90% of our long-term debt obligation beyond three years. Non-GAAP interest expense were flat quarter-over-quarter at \$84 million, and we project similar expense levels in the March quarter.

Turning to our outlook, we expect incremental improvements in mass capacity demand from both cloud and enterprise customers to more than offset seasonal-related decline in VIA and the legacy markets. With that as context, March quarter revenue is expected to be in a range of \$1.65 billion, plus or minus \$150 million, an increase of 6% sequentially at the midpoint.

We are planning for non-GAAP operating expenses of approximately \$260 million, as our temporary pay reduction ended late in the December quarter. At the midpoint of our revenue guidance, we expect non-GAAP operating margin to expand to the low-double digit percentage range, including underutilization costs of approximately \$50 million. We expect our non-GAAP EPS to be \$0.25, plus or minus \$0.20, based on a diluted share count of approximately 212 million shares, and a non-GAAP tax expense of \$27 million.

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

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Thanks, Gianluca. Heading into calendar 2024, we have increased confidence in a gradual nearline demand recovery that coincides with the launch of Mozaic. We believe this platform delivers sustainable areal density leadership with compelling TCO advantages, enabling data center operators to satisfy their increasing workload demands while conserving both power and space. This combination of capabilities is significant and our timing is fortuitous.

We've navigated the last seven quarters with discipline and focus while maintaining our product and technology execution plans. As a result, we emerge well-positioned to drive optimized financial performance to support our capital return commitments and return to our targeted profitability levels over time. Our strong execution is only possible through the tremendous efforts of our global team, and I would like to thank them for their resiliency and

dedication through this dynamic period. I would also like to thank our suppliers, customers and shareholders for your ongoing support of Seagate.

Operator, let's open up the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] And today's first question comes from Wamsi Mohan with BofA. Please go ahead.

Wamsi Mohan

Analyst, BofA Securities, Inc.

Q

Yes. Thank you so much. Dave, you alluded to the progress that you've made on Mozaic. Given what you know now, how would you characterize the outlook for maybe HAMR units in the second half of 2024 or perhaps into 2025? And I think you mentioned your first customer looking to transition to 3-terabyte HAMR. What kind of exabyte installed base opportunity is that? And maybe you could address it even more broadly across hyperscalers, that would be very helpful. Thank you.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

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Yeah. Thanks, Wamsi. Hi. So, we were very quantitative and prescriptive on the last call about the front half of this year. I think we won't be as much on the back half of this year, but the ramp is continuing on at a healthy pace. And we're continuing to look at all – what customers need on the last-generation platform, next-generation platform, trying to balance supply and demand really well because I think that's the primary metric that we're focused on and make sure we get financial predictability.

We'll drive the HAMR transition aggressively this year. And then, Mozaic really gets into when do we get to 4 terabytes per platter and how are we populating that chain. I mean, we expect to drive as many HAMR exabytes into 2025 as we can. So we're off to a good start, I think, and we're going up the ramp and trying to work the yields and get everybody qualified like we talked about. Nothing really changed in the last 90 days, I would say. Problems are – tough problems but the team is knocking them down. So, I'm pretty happy with that.

Wamsi Mohan

Analyst, BofA Securities, Inc.

Q

Okay. Thank you for that. And Gianluca, maybe could you help us just think about the margin ramp? I think you noted some headwind that will continue from underutilization charges, but you're also expecting the margins to increase all through calendar 2024. Could you maybe also help us think through, in that margin commentary, how – what the margin differential is between HAMR and CMR mass capacity drives and how that might change over time? Thank you so much.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

A

Hi, Wamsi. Yeah, good question. Well, first of all, our December quarter showed a good improvement in profitability. Our gross margin was up about 4%. Operating margin was up more than 5%. So, I'll say this profitability recovery already started. Part of that is, of course, coming from Mozaic cost actions that we have

taken in the last almost two years, and of course, the mix improvement, and of course, the pricing action also that we have taken in the last several quarters. So, this will continue to be reflected also in the future quarters. Mix, we continue to grow through more mass capacity, volume, and those cost actions are, of course, continuing to be very effective.

In term of the underutilization, depend a little bit what we ramped during the quarter. In the December quarter, we ramped a bit more of the wafers, but of course, it has high cost in our manufacturing to get ready for the shipment of the current quarter and next quarter in term of HAMR. And then now, we can maybe reduce a little bit the wafer and plan to move on the media, and of course, having more drive in the final test. So, depend a little bit on the mix inside our production.

So we said underutilization charges could be slightly higher, a little bit higher, but not very much higher, maybe just a little bit higher. So I expect that for the next few quarters to see mix going in the right direction, meaning more high capacity drive and starting to see the impact from some volume of HAMR. So March will not be particularly high volume, but we will have more in June.

And as Dave said, we will have even more into the second part of the calendar year. With business improving, demand improving, we go into possibly higher revenue and we are, of course, targeting to bring back our gross margin into the target range of 30% to 33%, as we said in the prior quarter, at a much lower level of revenue compared to the prior upcycle.

Wamsi Mohan

Analyst, BofA Securities, Inc.

Q

Thank you so much.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

A

Thank you.

Operator: Thank you. And our next question today comes from Erik Woodring with Morgan Stanley. Please go ahead.

Erik W. Woodring

Analyst, Morgan Stanley & Co. LLC

Q

Hey. Good afternoon, guys. Thank you very much for taking my question. Dave, I was wondering if you could just double-click again on some of the dynamics behind the hyperscalers and where their inventory is. How long do you see any more pain or what their behavior is, what your conversations look like? And then again, how they're responding to any pricing actions and production changes that you've been making over the last – or relative to 90 days ago? Thank you.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Yeah. The dynamics for them is very interesting and it has affected us quite a bit over the last year or so. I do think the inventory situation is much, much better than it was six months ago. So I'll dare say, it's basically cleaned up at this point. And it's going into the inventory changes going out and being consumed by the data centers again. So, we're much happier with that. The rate of consumption isn't what it was two years ago. And – but I do think it's going to accelerate a little bit.

And this is where we get into the forecast numbers of what the CAGR is, the exabyte CAGR. In 2020, we were in the high-50s, and then we stayed in the 30s for 2021 and 2022. And then for the first time ever, for the last year, year and a half, we've seen negative exabyte growth, which doesn't make any sense. We're forecasting still in the mid-20s right now, and it may be a little bit higher as people get into some of these replacement cycles that we talked about.

The interesting dynamic as I look back on the last year and a half was the push for AI and how it consumed a lot of dollars for the compute infrastructure that was going on in the data centers. And that's critical for most of our customers. They have been in a race to get as much compute memory for that compute online as they could to be able to handle all these AI applications everyone's talking about.

I do think ultimately, there's a data back end piece of that, and then also there's a fact that they were – as they were prioritizing that, they were letting the drives that they had in the data centers just continue to run. So, the replacement cycle for power and space and just overall cost benefits were all – we're definitely having those conversations with our customers. And then factoring that into what exactly our volume plans are for the next three years and saying this is what we're intending to build, this is the economics that you could get it through, and we've talked about this build to order before.

And I think we're getting a lot of good reception. There's a lot of other supply chains that are actually managed this way by these people. So, they understand it fairly well and they see the TCO benefits of the higher capacity drives. So they want to reach for that, plan it well and they'll get it. And we have to be careful, of course, because the factories have been so decimated by this downturn that we need to make sure that as we grow back, we grow back in a smart way.

Erik W. Woodring

Analyst, Morgan Stanley & Co. LLC

Super. Thanks so much, guys.

Q

Operator: And our next question today comes from Aaron Rakers with Wells Fargo. Please go ahead.

Aaron Rakers

Analyst, Wells Fargo Securities LLC

Yeah. Thanks for taking the question. I wanted to maybe just ask about the income statement, just the P&L trajectory from here. This guidance that you've given looks like it's the first kind of sequential increase in OpEx that we've seen, and I can appreciate improving fundamentals, et cetera. I'm just curious, how do we think about the pace of quarterly OpEx and maybe a normalized level of operating expenses looking out over a couple quarters? And then kind of building off of that, with free cash flow generation returning, just remind us again how you think about the capital structure and possibility of coming back into the market in terms of share repo? Thank you.

Q

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

Thank you, Aaron. Well, in term of OpEx, if you look, our trend has always been very positive in term of OpEx control, cost control. Just a few quarters ago, we were at well above \$300 million. So we went fairly low, especially in the last quarter, now at \$240 million. As I said in the prepared remarks, we have little bit of higher

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costs expected in this quarter because we took some extraordinary action on salary that ended at the end of last quarter. So, we have a little bit of higher labor cost.

As usual, we will focus on OpEx control. It's still a very, very good number. And I think in the next few quarter, we will stay around this level of OpEx until next fiscal year. As you know, in the current fiscal year, we don't have any variable compensation overall in our COGS and OpEx, but a big part is in OpEx. So, I think this level is probably reasonable for fiscal Q3 and fiscal Q4, and then next fiscal year, probably a little bit higher cost in OpEx.

Still, I think well below the \$300 million probably. Between \$270 million, \$280 million a quarter is probably a reasonable way to model it. Free cash flow, we had another positive free cash flow quarter. Of course, always very important for us to generate positive free cash flow. Revenue is increasing, profitability is increasing and, therefore, we expect free cash flow also to improve sequentially through the next few quarters.

Aaron Rakers

Analyst, Wells Fargo Securities LLC

Thank you.

Q

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

Thank you, Aaron.

A

Operator: And our next question today comes from Krish Sankar with TD Cowen. Please go ahead.

Eddy Orabi

Analyst, TD Cowen

Hey, guys. This is Eddy for Krish. Congrats on the HAMR launch. It's an exciting opportunity for you guys. I have a question regarding the customer value you are providing with these 32-terabyte HAMR drives. Will customers be enjoying lower price per terabyte versus 22 and 24-terabyte CMR drives, for example, or because HAMR yields haven't matured yet, this benefit will be more about power and space and the lower price per terabyte will take place in the future?

Q

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Yeah. It's a good question. We will balance everything, of course, what our yields are and our costs are and try to get the customers incentivized, but there is some incentive business provided by their power and space reductions as well. We call that their TCO proposition. So, all things in balance. I do think that the price per terabyte, if you will, is nominally the same. It may be just slightly lower, but there's definitely going to be a TCO incentive for the customers to move off of the lower capacities and [ph] onto higher ones (33:50).

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Eddy Orabi

Analyst, TD Cowen

That's great color. Thanks, Dave. And if we juxtapose the HAMR transition to the transition from LMR to PMR that took place back in 2006, 2008, you guys went from like 0% PMR mix to 100% within five to six quarters. Do you think the HAMR transition will be as quick or you see some reasons why this trend is maybe a little bit slower than the transition from LMR to PMR back then, and that [indiscernible] (34:19)?

Q

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

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Cycle times are a little bit longer now. So, I don't think it'll be as fast. I mean, I'd like it to be as fast and we'll continue to drive it as quick as we possibly can. The one thing I will say is that our last-generation PMR product, if you will, the 2.4 terabytes per platter drive that we've just talked about has a remarkably similar kit of parts as the HAMR drives do. So relative to what we're making one versus the other, it's not a big deal and we can get through customer transitions easier.

I think as we gain more confidence in a year over the 4-plus terabyte Mozaic platforms, then we'll definitely want to accelerate. Because by the time you get to, say, 5-plus terabytes, then it's such a great replacement on every legacy product that you have that we want to drive the whole portfolio there because utilization is much better in the factories and the costs come way down.

Eddy Orabi*Analyst, TD Cowen*

Q

Thank you, Dave.

Operator: Thank you. And our next question comes from Thomas O'Malley with Barclays. Please go ahead.

Thomas O'Malley*Analyst, Barclays Capital, Inc.*

Q

Hey, guys. Thanks for taking my question. I appreciate it. So, I just wanted to understand the move from qualification to revenue recognition. It sounds like with your largest customer, you're finishing qualification right now and you're obviously pointing to some big units in the first half. You mentioned on the call that you're expecting calls with the majority of the US cloud [ph] guys (35:49) and a couple others in calendar year 2024. Would you expect a similar timeframe between qualification and revenue recognition, AKA, like if those are getting qualified in the second half of this year, you could see revenue from a large number of additional customers? Just wanted to understand the timing.

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

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It's – yeah, thanks, Tom. It's complex. There are some customers that are relatively shorter qualifications and that – some of that's because of feature set, making sure we get the feature set checked out. If they're on a generic feature set that we're already shipping versus their own unique feature set, we have to make sure we're doing all those things, right? That's normal in any nearline transition. And I will say that a lot of people are seeing the TCO benefits. So, they're asking and trying to speed these qualifications through, right, because they want that benefit to flow through as well. We will also be limited on our ramp as to what we can do and the cycle times are quite long. So we're going to balance all these things together, if that helps you.

Thomas O'Malley*Analyst, Barclays Capital, Inc.*

Q

Yeah. That's helpful. And then, I just wanted to ask one on the margin side. So, you guys have talked about 20% below peak but still getting back to that 30% gross margin target or at least at the low end. If you look at what you're saying for mass capacity growth for the industry, mid-20s, if you just assign that to kind of your revenue ramp over the next couple of years, it takes probably a year and a half to kind of get to that \$2.5 billion, \$2.6 billion mark just using like a linear growth rate, is that the timeframe we should be thinking about until you get

back to that 30% to 32% gross margin or can you get there before, and what are the levers that get you there before revenue gets back to that \$2.5 billion, \$2.6 billion? Thank you.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

A

Thank you, Tom. Well, the major lever is HAMR. So the more we ramp up HAMR in, the better will be the margin. So we are becoming more and more positive on, of course, the timing of that continuous improvement in our margin. I would say we gave an indication last quarter in term of the level of revenue that we think we need to achieve in order to get a certain level of gross margin. That is probably – probably I'm getting a little bit more optimistic right now. So probably, we can do at even lower level of revenue. As you said before, qualification of customers is important, but we are working hard on qualifying more and more customers. So assuming we can continue our ramp on HAMR, I'm fairly positive we can do earlier than what you said and also at the lower level of revenue.

Thomas O'Malley

Analyst, Barclays Capital, Inc.

Q

Thank you, very much.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

A

Thank you.

Operator: And our next question comes from Karl Ackerman with BNP Paribas. Please go ahead.

Karl Ackerman

Analyst, BNP Paribas Exane

Q

Thank you. Gianluca, it's encouraging to see an improving gross margin trajectory, but it doesn't appear to be driven by price yet, given our math suggests that price per terabyte did fall low-single digits sequentially and year-over-year. Could you, perhaps, address whether we should expect previous action to raise prices across the channel may occur over the next couple quarters? And I have a follow-up, please.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

A

Hey, Karl. Well, I would say you can see the good improvement in our profitability. A good part of that is actually coming from pricing. Of course, you need to check into the like-for-like pricing. The mix has, of course, always a major impact on the average. We are very happy with what we are doing both on pricing and on cost. This quarter show a fantastic improvement in profitability, both gross margin and operating margin. And if you look at our guidance, this imply another strong improvement in profitability. So, pricing is a good part of that. Mix is another part of that improvement. And we will continue to do exactly – execute this strategy and we are very glad with the outcome so far.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Yeah. I would say, Karl, the raw demand is still not what it was two years ago. And so – and we have a supply chain that's not entirely healthy yet. We have to go continue to work on those actions. But I do think over time, especially incentivizing transitions to newer mass capacity drives, and then if there's price raises, it tends to be

more on legacy. And to the extent that everyone is under the same strain throughout the entire ecosystem, this is the trend that we're seeing and I think we'll probably take advantage of it.

My sense is that in the next year or two, we'll get to the point where we get high enough of the ramp that we can be very predictable, and then I think things will stabilize quite a bit. But we're not at a place where the industry has enough demand relative to the capacity that has online yet.

Karl Ackerman

Analyst, BNP Paribas Exane

Q

Very fair. That's it for me. Thank you.

Operator: Thank you. And our next question today comes from Kevin Cassidy of Rosenblatt Securities. Please go ahead.

Kevin Cassidy

Analyst, Rosenblatt Securities, Inc.

Q

Yeah. Thanks for taking my question and congratulations on the great results. You implemented a build-to-order program with your customers. Can you give an update on that? Is that still active and how is it giving you visibility?

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Yeah. Thanks very much. It is, and it's transitioned from my last comments as well because the industry, just at the levels that we're at, to build on my last comments, just can't fund the investments we need to make an areal density and exabyte growth over time and with the revenue and margins where it was. And what helps us is, to run factories, is the improved visibility and the predictability towards that end demand.

And so, I think that's why the HDD industry has changed fairly dramatically through this cycle this last six or eight quarters, because capacity did come off at the same time that people were – that demand was down and the industry is, therefore, underinvested in capital, and lead times are going up, as we've talked about before. So, we need this build-to-order framework to just get back to a healthy industry.

And we are rewarding predictability with our customers and we're incentivizing that predictability, and where people aren't predictable and they come in at the last minute for product that either we don't have it or they have to pay for our flexibility. I think that's the way we're thinking about it, and then making sure that we stabilize the supply base as well because it's not just ourselves as the HDD supplier, but we have numerous upstream supplies that need to be stabilized as well. So, it's still going to take some time.

Kevin Cassidy

Analyst, Rosenblatt Securities, Inc.

Q

Okay. Great. You mentioned the vertical integration of your laser technology. Is that a cost savings or is it more controlling the supply chain?

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Yeah. I think at this point, it's been a long time coming and we definitely value the suppliers that have helped us get HAMR products to market. We also feel like, given how intricate this silicon photonic circuitry is, is that we needed our own capability to control. But right now, it's more of a technology second sourcing, if you will. And so, we're going to continue to run with a few sources.

I think over time, there should be the opportunity to go drive the cost down and balance all things with multiple sources and the ability to control the investments that we make in capital, for example, and things like that. But it's been a long time coming. And part of the reason we're talking about it as part of Mozaic because it's very relevant as we get to 4 terabytes per platter and 5 terabytes per platter. I think also, there's been some noise out there in the industry about, well, as goes the ramp of that supplier, so goes the Seagate ramp, and that's clearly not true.

Kevin Cassidy

Analyst, Rosenblatt Securities, Inc.

Q

Understood. Thank you.

Operator: And our next question today comes from Steven Brian Fox with Fox Advisors LLC. Please go ahead.

Steven B. Fox

Analyst, Fox Advisors LLC

Q

Thanks for taking my question. Dave, I was just wondering if you could zoom out a little bit, without putting any kind of timeframe on it, to get to the 30% gross margins, it seems like you can almost get there from here on just the typical incremental margins from volumes. But based on everything you said, it doesn't seem that easy, especially early stage with HAMR versus later stage. So can you sort of walk through some of the puts and takes, say, over the next two to three quarters versus, say, when you hit that volume crossover where it becomes more smooth to get to the margin? It's just – there's been a lot of comments around this. Maybe you could just sum it up.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Yeah, and Gianluca can share some insights as well here. I think that first of all, we're ramping HAMR according to some prescriptive schedule. We can deploy it into certain mass capacity hyperscaler markets. We can also deploy it in other markets, depending on how we choose to do things, so we can put it in VIA markets, for example, over time. And the rate at which we are able to transition and our yields and scrap and things like that, especially once we get to 4 terabytes per platter, then I think that becomes more and more accretive in margin.

Fundamentally, though, I still think the demand picture actually is going to shape the next few quarters from a margin perspective. My sense is the demand has still not come anywhere close to where it was two years ago. We may see, with the growth of data and with investments that people need to make in data around with all these AI applications, we may see demand pick back up again, and that'll be the fundamental driver.

Gianluca, go ahead.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

A

Yeah. No, I said that before, I think the combination of stronger demand through the cycle and our very good product based on HAMR technology will drive further improvement in gross margin, sequential improvement. I think we will have sequential improvement through the entire calendar 2024 and this is, of course, based on our

view of the ramp of HAMR and also the recovering from the prior downcycle that we expect, especially in the mass capacity, to continue through the entire calendar 2024 and actually even calendar 2025 and later.

Steven B. Fox

Analyst, Fox Advisors LLC

Q

That's helpful. Just can you fill in one other blank, which is back-end testing capacity? How does that sort of help/hurt margins as this ramp happens? Thanks.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Based on where we were from legacy products years ago on desktop and so on, and then even just the volumes we were at a couple of years ago, I think we have plenty of back-end test capacity.

Steven B. Fox

Analyst, Fox Advisors LLC

Q

But is it a longer test cycle, though? Is it a longer test cycle a you're looking for...

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

It is, it certainly is. The bigger the drive, the longer the test cycle. But we still have plenty of capacity to cover the demands at this level.

Steven B. Fox

Analyst, Fox Advisors LLC

Q

Awesome. Thank you.

Operator: Thank you. And our next question comes from Timothy Arcuri with UBS. Please go ahead.

Q

This is [ph] Leo on (47:55) for Tim. Thanks for taking my question. Just one for me. You don't report orders, but perhaps you could give us some color on book-to-bill and just some idea of where orders are relative to revenues and how that book-to-bill has been trending and where you think that's going over the next couple of quarters, that would be helpful. Thanks.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Thanks. Yeah. That does get into our build-to-order plans. We are definitely, like I said before, very prescriptive on what we're building for people two, three, four quarters out. And as long as we all stay on that plan, I think that's predictable economics for our customers as well. So, it's going better and better every quarter.

I think when we first launched this, there was questions that I was getting on these earnings calls about supply is so far below – or sorry, since demand is so far below supply today, how can you do something like this, but we need that predictability in order to run the supply chain and reward everyone upstream of the supply chain. So, so far, the progress has been fairly good and we're getting better visibility into next quarter and beyond.

Operator: Thank you. And our next question comes from Vijay Rakesh with Mizuho. Please go ahead.

Vijay Raghavan Rakesh

Analyst, Mizuho Securities USA LLC

Q

Yeah. Hi, Dave and Gianluca. Just on the enterprise hard disk drive side – or on the hard disk drive side, do you see, given the 25% exabyte growth and recovery on the PC side this year, do you expect those revenues to get back to that \$2 billion run rate exiting 2024, I guess – calendar 2024?

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

A

Yeah. We don't guide after this quarter. So, we just gave a good guidance for the March quarter in term of revenue increase and profitability increase. And as we said, we are ramping HAMR volume. We are seeing better demand environment. So we expect sequential improvement through the quarter, but we don't give specific guidance on revenue for the end of the calendar year.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Yeah. I would say that, obviously, we're watching nearline demand, CSP demand, on-prem enterprise demand continuing to build strength, but not nearly be as big as it was a couple of years ago, but that's very good and we're being very careful building into it. The one point that you just raised, which was the whole AI PC demand, which I think it's still very early innings in this, but we do see opportunity there. High-end workstations, if you will, that are running AI applications may actually be an interesting opportunity.

Vijay Raghavan Rakesh

Analyst, Mizuho Securities USA LLC

Q

Got it. And then on the gross margin line, sorry to belabor that, Gianluca, do you see you guys getting back to that target rate window, 30%, 33% exiting this year? And especially on the HAMR side, I think Dave mentioned you can do, with 4 terabyte-plus, 5 disks for a 20-terabyte drive versus 7 to 10 disks now. What are the gross margins on HAMR versus where you see your corporate margins today, I guess?

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

A

Yeah. We know we said in the past, HAMR drives gross margin is, for sure, accretive to the corporation. So, it's always above our average. Right now, as you know, there is no HAMR drive in our result. But we see starting in the March quarter, and you already see some improvement in our guidance. It will be, I expect, more when we go into the June quarter and through the rest of the calendar year. So, we are positive on the profitability from that product. And we need to take our time to qualify big customers and then to start ramp, because as Dave said, we take a little bit of time to ramp high volume production for the new product.

Vijay Raghavan Rakesh

Analyst, Mizuho Securities USA LLC

Q

Got it. Thanks.

Operator: Thank you. And our next question comes from Ananda Baruah with Loop Capital. Please go ahead.

Ananda Baruah*Analyst, Loop Capital Markets LLC*

Q

Yeah. Good afternoon, guys. Thanks for taking the question. Really appreciate it. I guess for Dave and, Gianluca, jump in here, too, the hyperscalers are sort of having some conversation about data center redesign over the coming years. A lot of this is around GPU compute. But they are referring to it as data center reasons on more [indiscernible] (52:54). And I guess would there – if that occurs, do you have any opinion on if there would be incremental opportunity for nearline drives that would, I guess, substantively be like in addition to whatever data growth that's going on? So overall, I just wanted to see if you have any thoughts on that and any context. And that's it. Thanks.

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

A

Yeah. Ananda, it's a real complex topic. What I would say is that the compute infrastructure is changing dramatically and the memory architectures will change to support that computer architecture very dramatically as well. So, there is a lot of redesign discussion going on.

There are different types of applications, and things that are being branded AI, there's stuff that's very focused on text or large language models, and then there's image recognition and video creation. And so, there's a lot of different types of applications propagating. And I think this is just normal application development that's been going on for years and years and years, but I do think there's different types of hardware.

So, I think there are some now AI data centers being discussed that are largely compute. I also think that some of these applications are spinning off a lot of data. And they're requiring data to be stored for a certain period of time and then brought back up to the higher levels to be reprocessed. And so, that's just normal data growth as well.

So I think the net of it is, is there's a lot of architectural redesign going on, probably not affecting the tiers that we're in. If anything, and we made reference to this in the prepared remarks, there's cost power and space are at a premium. There's many AI applications from what I'm hearing that there's just not enough power for. And power infrastructure is going to be critical, but to the extent that you can do your part sort of by transitioning to higher capacity drives that, net-net, gives you the same exabyte capacity with less power. I think that's a good thing. It may be an opportunity for us.

Ananda Baruah*Analyst, Loop Capital Markets LLC*

Q

So, that would be in addition to like the 25% kind of data run rate-driven, that sort of power is a catalyst, Dave?

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

A

Hard to say. It depends on the builds and how much people are having to pay for it. Again, I think in the AI applications that are really exploding right now, power is going to become one of the limiting factors. And so, to the extent that there may be a really good payoff in not only cost savings, space savings and so on, but also just freeing up that power infrastructure to go do other things, I mean, that might actually help us get above the 25%.

Ananda Baruah*Analyst, Loop Capital Markets LLC*

Q

Thanks a lot. Appreciate it.

Operator: Thank you. And our next question comes from Mark Miller with The Benchmark Company. Please go ahead.

Mark Miller

Analyst, The Benchmark Co. LLC

Q

Thank you for the question and congratulations on the launch of Mozaic. I'm just wondering, you mentioned it briefly, what kind of traction are you seeing from AI-related opportunities, and what do you – how do you see that ramping throughout the year?

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Yeah. Mark, you know me, I'm pretty cynical sometimes on these things and I'm looking for POs that actually say AI on them. And they are starting to happen but it's still fairly small. And again, I'll go back to my previous comments, these are really applications that have been developing, on a lot of fronts, over many years anyway. So say, for example, image recognition, whether it's at the edge or in the cloud, that application space has been developing over time quite a bit.

When we get into specific things like large language models, where people talk about, I think the data infrastructure impact piece is still secondary to the compute piece, even at this point. So at some point, there will be compute enabling all these really cool applications and efficiencies that people and businesses like ours were taking advantage of, and then the data will continue to grow on the backside of that. But we're still early innings on that.

Mark Miller

Analyst, The Benchmark Co. LLC

Q

So that's more 2025, do you think?

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

For large language models, I'd say maybe. I don't know exactly.

Mark Miller

Analyst, The Benchmark Co. LLC

Q

Thank you.

Operator: Thank you. And ladies and gentlemen, this concludes our question-and-answer session. I'd like to turn the conference back over to management for any closing remarks.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Thanks, Marco. Seagate is focused on executing our product roadmap, leveraging the advanced technologies in our Mozaic platform, which we believe positions us well to enhance profitability over the near term and to capture long-term opportunities for mass capacity storage. I'd like to close by once again thanking all of our stakeholders for their ongoing support at Seagate. Thanks for joining us today and we look forward to speaking with you during the quarter.

Operator: Thank you. This concludes today's conference call and we thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.

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