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Seagate Technology Holdings Plc (STX)

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and welcome to the Seagate Technology Fourth Quarter and Fiscal Year 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, Investor Relations. Please go ahead.

Shanye Hudson

Senior Vice President-Investor Relations and Treasury, 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've posted our earnings press release and detailed supplemental information for our June 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'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.

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 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 in our SEC filings, including 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 on the Investors section of our website.

Following our prepared remarks, we'll open the call for questions. In order to provide all analysts with the opportunity to participate, we thank you in advance for asking just one primary question and then reentering the queue.

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

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Thank you, Shanye, and hello, everyone. Seagate ended fiscal 2024 on a high note, reflecting strong operational execution and more favorable supply-demand dynamics. Fourth quarter revenue increased 18% year-on-year, supported by strengthening global cloud demand. We achieved non-GAAP gross margin of nearly 31% at the company level, supported by HDD gross margins that were above that level and at the top end of our long-term

target range. These results, along with ongoing expense discipline, led to non-GAAP EPS of \$1.05, far exceeding the high end of our guidance range.

At the start of the fiscal year, we highlighted three financial priorities, namely; to increase profitability, drive cash generation, and strengthen our balance sheet. Reflecting on our full year performance, we delivered on all three. Our results were due in part to the build-to-order or BTO strategy that we put in place to provide greater supply-demand predictability and optimize our cash resources.

For fiscal 2024, we expanded non-GAAP operating profit by 64%, grew free cash flow sequentially every quarter of the fiscal year, and maintained healthy liquidity levels. As we enter the new fiscal year with operating and financial momentum in an improving demand environment, executing our mass capacity product road map is a top priority.

In the September quarter, we expect to complete the HAMR-based Mozaic 3+ product qualification with our lead CSP partner. We've also started to ramp our 28-terabyte PMR/SMR product platform drives in high volume. These two product advancements align well with the strengthening nearline demand environment. I'll share further details around our product execution momentarily, but, first, I'll briefly review the current market trends.

As I highlighted a moment ago, we are seeing strong nearline cloud demand growth from customers globally. Fourth quarter nearline cloud revenue more than doubled from the year ago period, and we expect growth to continue in fiscal 2025.

We attribute the underlying demand drivers to an increase from both traditional cloud computing workloads, as well as new AI-related deployments. We believe this demand rebound follows a period of deferred HDD storage investments by cloud providers as they prioritize spending towards compute-intensive infrastructure.

While cloud service providers are continuing to build out that infrastructure, they increasingly focus on developing, deploying and monetizing AI applications. This involves both training of large language models and expanding the entire hardware stack to support future generative AI content-driven growth.

While HDD demand pull-through related to AI is still relatively small, we believe HDDs will play a crucial role in enabling both of these phases of the AI adoption curve. By offering cost-efficient, scalable storage solutions, HDDs are ideal for maintaining the integrity of AI training data sets as well as preserving the valuable content that AI engines are projected to generate in the future.

In the enterprise OEM markets, we observed a gradual improvement in demand for the second consecutive quarter; and continue to project stronger growth in the second half of the calendar year, driven by both modest improvement in traditional server unit demand and increased exabyte content.

We've also started to see incremental demand for higher-density storage specific solutions, due in part to enterprises putting storage capacity in place, either on-prem or in private clouds, as they prepare for future AI applications.

Finally, turning to the VIA markets. Sales of our VIA products came in better than we expected in the June quarter, while customer inventory remains at healthy levels. We expect VIA sales will likely fluctuate a bit in the second half of the calendar year, off of this higher base.

Global demand indications for smart city projects remained strong, but near-term budget visibility for these projects is mixed in many markets amid the current global macro uncertainty. Overall, the end market demand trends are solidly pointing to long-term growth opportunities for mass capacity storage.

Demand recovery for our high capacity nearline drives has been faster than anticipated, which has extended product lead times and led to tighter overall supply conditions. Based on our current outlook, our nearline exabyte supply is committed through the end of the calendar year. These trends underscore the relevance of our BTO strategy, which is intended to provide greater demand predictability for Seagate and supply assurance for our customers.

In this environment, we are working with our customers to obtain better demand visibility and address their exabyte growth needs through product transitions while maintaining a strong focus on profitability and supply discipline.

As noted last quarter, we are executing the qualification and ramp of two new high-capacity drives. Transitioning to these higher capacity products enable Seagate to profitably expand exabyte shipment volume with our existing head and disk production capacity while also supporting our customers' growing data demand and TCO needs.

Customer acceptance of our new PMR product continues to gain momentum. These drives, which offer capacities of up to 28 terabytes, have demonstrated solid yield, quality and performance to date, with numerous customers now qualified spanning the cloud, enterprise and VIA markets, and several more planned to complete in the coming months. Volume ramp is already underway.

In the June quarter, we shipped a small volume of HAMR-based Mozaic drives for revenue to non-cloud customers. Consistent with our recent public commentary, our lead CSP customer is validating drives built with the improved process controls and new firmware optimized for their specific workloads. Testing on these drives is progressing to plan, and we expect to complete qualification and begin shipping them revenue units later in the September quarter.

Based on our confidence in the technology and experience on this product platform, we are proceeding to launch new HAMR qualifications with the expectation to have multiple US and China cloud customers [ph] qual is (09:35) underway this quarter. We estimate these qualifications will take around three quarters, on average, to complete, which points to a broader volume ramp toward mid-calendar 2025. We are leveraging all of our learnings and pushing the pace of development on our next generation of HAMR drives, the Mozaic 4+.

Mozaic 4+ offers 33% more capacity compared with the HAMR drives that we're shipping today with minimal changes to the bill of materials. This illustrates the central value proposition of the Mozaic platform, namely the technology's ability to scale drive capacity through areal density gains rather than adding heads and disks.

This capability is enabling Seagate to deliver significant cost benefits to our customers as well as offer power and space advantages that are particularly valuable for data center operators as they expand cloud and AI infrastructure. For example, each data center slot loaded with one of our Mozaic 3+ drives offers 3 times the storage capacity relative to the average capacity of nearline drives in our installed base, and consumes about 70% less power per terabyte. These represent tremendous savings opportunities for data centers at exabyte scale.

We are hearing from customers directly, including CSPs, that HDDs already play a crucial role in extracting value from data in the early stages of AI application deployment. As gen AI engines mature, customers expect an

acceleration in content creation that will lead to significant demand for mass capacity storage. We recognize that gen AI is still in its early stages of adoption. However, this customer feedback combined with our early engagements with nearline cloud and OEM customers reinforces our view that mass capacity storage will be a beneficiary in both the cloud and at the edge as the adoption of these new exciting applications take hold.

I'll stop there and pass the call over to Gianluca.

Gianluca Romano

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

Thank you, Dave. Seagate delivered a strong June quarter financial performance, underscored by double-digit revenue growth on both a sequential and year-over-year basis, with profitability exceeding the high end of our guidance range.

For the June quarter, revenue was \$1.89 billion, up 14% quarter-over-quarter and 18% year-over-year. Non-GAAP operating income was up 79% sequentially to \$327 million, leading to non-GAAP operating margin of 17% of revenue, expanding 620 basis points quarter-over-quarter. And our non-GAAP EPS was \$1.05, exceeding the high end of our guidance range, reflecting the improving exabyte demand trend, ongoing price adjustment, and continued cost discipline.

Within our hard disk drive business, exabyte shipments grew 15% sequentially to 114 exabytes, while revenue increased 17% to \$1.7 billion. Growing demand for our mass capacity products more than offset a sequential decline in the legacy and non-HDD businesses. Within the mass capacity market, revenue increased 22% sequentially to \$1.4 billion, driven by strengthening global nearline cloud demand along with an improvement in the VIA market. Mass capacity shipments totaled 104 exabytes compared with 89 exabyte in the March quarter, up 17% sequentially. Mass capacity shipments now represent more than 90% of total HDD exabytes, reflecting the continued long-term secular growth for cost-efficient scalable storage.

Seagate nearline product portfolio has us well-positioned to address this growing demand. In the June quarter, nearline shipment totaled 84 exabyte, up quarter-over-quarter from 72 exabyte. We expect demand will continue to improve from global CSPs as well as nearline enterprise customers into the back half of calendar 2024.

As Dave mentioned, demand for our VIA product was better than we had forecasted in the June quarter, which is more a function of order timing as our VIA revenue outlook for the calendar year has not changed. Finally, legacy product revenue was \$290 million while revenue for our non-HDD business was \$160 million, both down slightly on a sequential basis and lower than expected at the beginning of the quarter.

Moving on to the rest of the income statement, non-GAAP gross profit increased sequentially by \$151 million in the June quarter to \$583 million. This represent a 45% increase in gross profit compared with similar revenue level in the December 2022 quarter. Importantly, we achieved a non-GAAP gross margin of 30.9% at the company level, which is well inside our long-term margin range. Overall, non-GAAP gross margin expanded by 480 basis points quarter-over-quarter, which was faster than we had originally anticipated.

As Dave noted, margin for hard disk drive business were notably higher than the corporate margin. Our outperformance is supported by continued price adjustment, favorable mix shift toward mass capacity product, and ongoing cost efficiencies. Underutilization costs decreased to roughly \$20 million compared to \$43 million in the previous quarter. We expect underutilization costs will be minimal going forward, reflecting the improving demand environment.

Non-GAAP operating expenses totaled \$256 million, up 3% quarter-over-quarter, roughly in line with our plans. Adjusted EBITDA continued to improve and was up 45% sequentially in the June quarter to \$404 million. Non-GAAP net income strongly increased to \$222 million, resulting in non-GAAP EPS of \$1.05 per share based on diluted share count of approximately 212 million shares.

Moving on to cash flow and the balance sheet, in the June quarter, cash and cash equivalents totaled \$1.4 billion, including \$560 million, representing a majority of the proceeds from the sales of our SoC assets announced in April. From an accounting perspective, we recorded \$226 million of the proceeds in operational cash flow, which are net of transaction costs and related to our long-term SoC purchase agreement. The remaining proceeds are reflected in invested cash inflow.

Capital expenditures for the quarter were down 10% to \$54 million. For the fiscal 2024, CapEx spending was \$254 million, which is just below the low end of our target 4% to 6% of revenue. Looking out to fiscal 2025, we will maintain capital discipline and currently expect CapEx to be at the low end of the target range.

Free cash flow generation was \$380 million, including the \$226 million noted earlier from the SoC divestiture. As a reminder, we plan to use a portion of this proceed to support our supply chain. With this in mind, we expect free cash flow in the September quarter to be at or slightly above breakeven.

We returned \$147 million to shareholder through the quarterly dividend, exiting the quarter with 210 million shares outstanding. We closed the June quarter with \$2.9 billion in available liquidity, including our undrawn revolving credit facility. With cash and cash equivalents of \$1.4 billion, net debt decreased 11% to \$4.4 billion at the end of the June quarter.

Other income expenses were \$81 million, down from \$85 million in the prior quarter and reflecting higher interest income from improved cash balance and relatively flat interest expenses.

Turning now to our outlook, we expect mass capacity revenue to trend higher in September quarter and more than offset lower sales into the legacy markets. We continue to see demand growth from global cloud customers as well as a modest improvement in the nearline enterprise market.

We expect gross margin to benefit from a richer mix of mass capacity revenue and ongoing pricing actions. With that as context, September quarter revenue is expected to be in a range of \$2.1 billion plus or minus \$150 million, an increase of 11% sequentially and 44% year-on-year at the midpoint.

We are planning for non-GAAP operating expenses of approximately \$270 million, which include costs associated with reinstating our variable compensation plan. At the midpoint of our revenue guidance, we expect non-GAAP operating margin to be in the high teens percentage range. We expect our non-GAAP EPS to be \$1.40 plus or minus \$0.20 based on a diluted share count of approximately 213 million shares and a non-GAAP tax expense of \$15 million to \$20 million. Our results reflect our supply discipline and strong focus on profitability.

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. I'm pleased with our strong performance exiting fiscal 2024, which reflects our team's unwavering focus on improving profitability and driving cash generation. Two key financial imperatives. As we enter fiscal 2025 amid improving nearline cloud and enterprise demand, we will focus on supporting exabyte

growth through product transitions. We are working closely with customers to address their data storage needs through two new high-capacity products, including the Mozaic 3+ HAMR drives. We remain confident in the HAMR technology, which provides our customers with cost-efficient scalable storage that we believe will prove critical in an era where data holds unprecedented value.

We want to thank our global teams for their creativity and perseverance over the last several quarters that have helped us achieve the results that we announced today. Our structural performance improvements coupled with a favorable demand environment and differentiated technology road map position us well for years to come. We also wish to thank our suppliers for your support and our customers and shareholders for placing your trust in Seagate.

Gianluca and I are now ready to open the call for questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question today is from Wamsi Mohan with Bank of America. Please go ahead.

Wamsi Mohan

Analyst, Bank of America Merrill Lynch

Q

Yes, thank you so much. Dave, you mentioned that nearline capacity is committed through end of calendar 2024. How should we think about the market coming more in supply-demand balance and when do you think that would happen? Or maybe asking it other way, how long would it take for you to add incremental capacity and how do we square that with the low end of CapEx for fiscal 2025 comments from Gianluca? Thank you.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Thanks, Wamsi. Yes, we are being very careful with adding more capacity. It's good news seeing the demand come back to the extent that it has, but it's still not back to the levels it was a couple years ago. And if you'll recall, we took something like 25% of the capacity offline, and we let a bunch of people go. And so we've been hiring a lot of the people back, but we're still pretty far away from the supply capabilities that we had years ago.

What we're doing right now is trying to get predictable, so making sure that with the supply that we do have, we're getting it booked, and that's why we have the confidence through the end of calendar year. And then we're trying to drive product transitions, which helps us answer the call for exabyte demand with the new products and making sure we get that booked, so people are committed to the qualifications and then can have access to that technology as well, which obviously helps us rebuild the industry and the margins that we have. We can share that with suppliers as well. So, just that predictability is our priority right now, not adding more capacity.

Wamsi Mohan

Analyst, Bank of America Merrill Lynch

Q

Okay. Thanks. If I could, really quick one for Gianluca. In your guide of the gross margin improvement, right, as you've gone through the last few quarters, you've been seeing material step function changes in your gross margin as some of these underutilization charges have gone away on these higher revenues.

As you think about this quarter-on-quarter into September and beyond, it seems that the gross margin improvement is sort of [ph] asymptoting (24:16) and I'm wondering. Is that more because of the ramp and qualification around HAMR and sort of where those volumes are this year or should we think that we won't get as much leverage on gross margins over the next few quarters? How should we be thinking about that? Thank you so much.

Gianluca Romano

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

A

Thank you, Wamsi. Well, I would say, first of all, we are very satisfied with the trend in our gross margin. This quarter, I mean, the June quarter was even a little bit higher than what we were expecting. So, we went a little bit faster on both the pricing actions and the reduction in our internal cost.

This is going on. We expect this to happen again in the September quarter. It's always difficult to perfectly estimate how much will be the impact for the full quarter. As you know, volume is going up so the underutilization charges will decline even more in September and we don't really expect this cost to be impacting the company through fiscal 2025.

And then, of course, because of the supply-demand balance now is a little bit different than what was in past, we still expect some improvement on the pricing action. So, everything is reflected in our guidance and know the trend is continuing and is going in the right direction.

Wamsi Mohan

Analyst, Bank of America Merrill Lynch

Q

Okay. Thank you so much.

Gianluca Romano

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

A

Thank you.

Operator: The next question is from Asiya Merchant with Citigroup. Please go ahead.

Asiya Merchant

Analyst, Citigroup Global Markets Canada, Inc.

Q

Great. Thank you for taking my question. The guide talked about improving enterprise storage demand from your enterprise OEM customers. How much visibility is there and how do you feel about the sustainability of that demand as the quarters progress? Thank you.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Thanks, Asiya. I would say that the visibility is not as good as what we have from the CSPs today, but it's been a fairly sharp downturn in on-prem enterprise as well over the last year. So, talking to the customers, they see some of that coming back, maybe not as early, but probably into FY 2025 later in the year. So, that's what we're targeting right now and again, trying to get the new products qualified there so we can answer it with exabytes.

We think that over time, on-prem is going to grow because a lot of the cool applications that people are talking about read AI applications, will need on-prem storage as well for various reasons, snapshotting and check

pointing of the data and just making sure you feed all the AI engines with mass data at the edge. So, we think there's opportunity there, but it's definitely lagging what we're seeing in the CSPs right now.

Asiya Merchant

Analyst, Citigroup Global Markets Canada, Inc.

Thank you.

Q

Operator: The next question is from Erik Woodring with Morgan Stanley. Please go ahead.

Erik W. Woodring

Analyst, Morgan Stanley & Co. LLC

Great, guys. Thanks a lot for taking my question.

Q

Dave, [ph] earlier you (27:35) provided an update on HAMR timing tonight. Those comments are obviously helpful in understanding the ramp. I guess I want to provide some assurance for the market on timing and that is just if I were to ask from 1 to 10, 10 being highest conviction, how much conviction do you have that HAMR will qualify for your first major cloud customer in the September quarter and why? Thanks so much.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Well, yeah, we're pretty convicted from our comments in the prepared remarks, of course. In short, Erik, we're looking at the data, and we have thousands of drives running in our shop. We have at the customer sites as well. They're running under a variety of workloads and we're mindful of the fact that we have to prove the long-term performance. We had some supplier issues during the course of this summer when we went to high volume, but we see the fixes and we see how they're responding in the test beds that we've got. So, we're very optimistic about getting through these things.

A

Our industry has really upped its game as the drives they have to last for five, six, seven years in the data center. It takes a little time to prove that kind of performance. We can't just fix that in a week. We have to actually prove it ourselves. So, the bar is pretty high, but we'll get over the bar really soon, and that's why we're optimistic about it.

Erik W. Woodring

Analyst, Morgan Stanley & Co. LLC

Super. Thanks so much, Dave.

Q

Operator: The next question is from Krish Sankar with TD Cowen. Please go ahead.

Krish Sankar

Analyst, TD Cowen

Yeah. Hi. Thanks [ph] for taking my (29:09) question. I have a two-part question, one for Gianluca on gross margin. It looked like September quarter gross margin is up probably like 50 to 100 basis points. Is it a fair characterization and do you have any update to your long-term gross margin target since you're already there?

Q

And then Dave, you kind of spoke about exabytes committed for this year. Any view on FY 2025 or calendar 2025 exabytes for you or for the industry? Thank you.

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

A

In term of gross margin, as I said before, we are going in the right direction. We have improved our gross margin by a lot in the last three or four quarters so we are pleased with this trend, and we see further improvements coming in the current quarter. And then as we discussed also in the past, we see both revenue and profitability continue to improve through the calendar 2024.

So, we are fairly optimistic. Of course, we always need to check supply and demand balance, and we need to have enough volume to bring underutilization charges to zero. And right now, it is in our forecast. So, we are going in the right direction, and, no, we are not giving a new range for now, but as Dave said in his script, especially the hard disk part of the business is particularly strong and is already at the top of what we have in the current model range in term of gross margin.

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

A

And then Krish, relative to your question for me, there is some evidence that the cloud continues to strengthen going into calendar 2025. We don't want to talk about that too much just yet, but I think enterprise on-prem will, this is to Asiya's question, will improve in exabyte demand as well in calendar 2025.

Our exabytes are fairly committed through calendar 2024 so we have limited supply and FY 2025 is starting to fill up. And for customers needing more exabyte scale, that's why we're driving the mix via new product introductions so hard that we talked about.

Krish Sankar*Analyst, TD Cowen*

Q

Thank you, gentlemen. Very helpful. Thank you.

Operator: The next question is from Amit Daryanani with Evercore. Please go ahead.

Amit Daryanani*Analyst, Evercore Group LLC*

Q

Yeah, good afternoon. Thanks for taking my question. I have two as well, I guess. I guess just both on pricing, especially in the mass capacity side, it looks like your pricing is up mid-single digits, maybe even slightly better than that. Can you just talk about how do you see the pricing trajectory on a year-over-year basis pan out through the end of this calendar year through fiscal year? Would love to just get a sense on the pricing side.

And then Dave, when you talk about these HAMR volumes happening in mid-2025, so the pushout you've seen, there's always this fear that as people, as investor, as customers wait for HAMR ramp, Western Dig will pick up more incremental share versus Seagate. So, can you just talk about what are customers broadly doing as a way for these HAMR qualifications to happen and what gives you comfort that perhaps the market share doesn't go away from you as these qualifications happen over the next few quarters? Thank you.

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

A

Well, I think we have products all the way from 20 to 32 terabytes and we're going to go to 40 terabytes and we're just asking customers exactly what they want to fill their exabyte demand. So, I think we have a lot of options and we're making sure we're as predictable as we possibly can be.

So, market share is an outcome and what we said many, many times is we're going to go build-to-order. We're going to communicate with the customers exactly what's going on. So, I'm not really worried about market share. It's more how do we predictably run our factories, long lead times on the products and supply is fairly tight right now. Making sure we get the customers exactly what they need when they need it is really our priority.

And that does transition into the pricing discussion, which I'll let Gianluca answer here in a second, but what I would say is if you look back six months ago before we started to see some of this demand uptick, we said we're not taking some deals that we thought were dilutive – increasingly dilutive to our industry. And now as we see better and better dynamics, tighter supply dynamics and so on, we've taken the deals, obviously, the back half of this year. And where it goes from here really is dictated by the continued demand, so how big is the demand next year with all these new applications that people are talking about.

Gianluca Romano

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

A

Yeah. On the pricing, of course, we are coming out from a fairly long down cycle and we have started to increase our pricing based on the increased demand a few quarters ago. Part of the pricing is already included in our build-to-order that Dave already discussed, so [ph] there is (34:03) part of the volume that already include a certain pricing for the next several quarter.

[ph] And there is (34:09) another part that will be discussed during the quarter in term of upside and in different segments, in some segments. Now, the demand is strong, especially in the cloud. Enterprise OEM is also starting to improve. That is very good for us. Video imaging application. I think through the end of the calendar year will show some further improvement. Of course, there is also part of the business more in the legacy side that is not currently growing.

Obviously, the industry is becoming more healthy. The ecosystem is improving so the pricing trend is going in the direction where we have discussed also in the last couple of quarters. And course, it's part of the improvement that we can see in the gross margin.

Amit Daryanani

Analyst, Evercore Group LLC

Q

Perfect. Thank you very much.

Operator: The next question is from Aaron Rakers with Wells Fargo. Please go ahead.

Aaron Rakers

Analyst, Wells Fargo Securities LLC

Q

Yeah, thanks for taking the question. Kind of digging a little bit into the gross margin drivers, one of your competitors talks a lot about SMR and I know in your slide deck, you highlighted the 28 terabyte SMRs going now through qualification. I'm just curious of how much of your nearline business today is on SMR and if not a lot, how much does that ramp change the trajectory of gross margin. Just trying to isolate that SMR benefit that I think could play out from gross margin.

And then I guess, Gianluca, on gross margin, I'm curious. Excluding the underutilization charges, it to me looks like you're guiding gross margin more or less flat sequentially. Is there any drivers of why you wouldn't see the same kind of incremental margin flow-through in the model this quarter relative to what you've seen over the last two quarters or so?

Gianluca Romano

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

A

Yeah, I would say the June quarter came out better than what we were expecting so we have anticipated a little bit of that gross margin improvement in the June quarter. Again, we are very positive for the current quarter. We have included in the guidance what we already have agreed with customer, and then we will see how the quarter will come out, can come out also a little bit better than what we expect in term of pricing, but course, depends on what are the negotiation through the quarter.

We are happy on the cost side. Cost is declining so this is helping us and it will be another step during the second part of the calendar year. So, in term of SMR, I don't know if, Dave, you want to answer that question.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Yeah. Hi, Aaron. So, on SMR, I would just say, look, we've qualified SMR at all customers that want it and SMR as a percentage of the total is really a function of what customers' pulling in a given quarter. And so we work with the customers that they happen to want – there's different flavors of SMR. There's some people who need variance of CMR and there's a lot of different complexity in the customer base. We'll ship whatever the customer needs.

Relative to margins, SMR, does it help margins or hurt margins? It's not very relevant. It helps capacity points in some cases and that's important for individual customers, but we have options to go where we want to on different flavors of SMR if we have to.

Aaron Rakers

Analyst, Wells Fargo Securities LLC

Q

Yeah. Thank you.

Operator: The next question is from Timothy Arcuri with UBS. Please go ahead.

Timothy Arcuri

Analyst, UBS Securities LLC

Q

Hi. Thanks. I think in the past, you said that your max exabyte shipment capacity is about 120 exabytes. You just shipped 114 exabytes. You're going to ship more in September. So, in the not too distant future, you're going to kind of bump up against max capacity. I know, Dave, you said that you're hiring folks back and stuff, but we're going to kind of get to a point where you've been raising prices. But how do you think about strategically? Do you sort of slow roll the capacity expansion and so that you don't really grow that number very much and you instead take price? Or do you just think about more of a modest price increase trajectory and you basically back solve into what you have to expand in terms of capacity? How do you think about that balance?

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Yeah. Thanks for the question, Tim. So, we're going to be very cautious given what we've just been through. So, it's not ancient history, and I guess the scars are fairly fresh on our back, not only us but our entire industry, right? So, the entire supply chain needs to recover.

I think as we start to look out further and people are booking with more confidence things further along, we'll probably add back some people, use some of the existing capacity that we have, top out at that 125 number or maybe slightly higher than that, which we'll work as tough as we can inside of operations to do that.

We can grow more exabytes by getting through product transitions and that's one of the reasons why we're trying so hard to get through the product transition. So, we don't have to necessarily answer it with new CapEx. We have the CapEx that can actually go through the product transitions already and that's the way we're going to answer it first. And then we'll see how much demand continues above that.

Historically, as you all know, demand has been significantly higher for HDDs before the pandemic and even in sometimes during the pandemic. So we've been through a wild ride from a supply chain perspective; and if the demand, especially with some of these new applications that are coming online, continues to go north, we'll have to deal with that at the time. I think it's too early to do that yet.

Timothy Arcuri

Analyst, UBS Securities LLC

Q

So, is there some number that the customer is bearing to, I mean, willing to bear, Dave? Is it like, do you think the customer can bear these sort of 5% to 10% price increases? I mean, those are the kind of numbers we're hearing for the back half of the year. It seems very high and not a number that the customer probably can bear.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Well, the way I would think about it instead is, as we go to higher and higher capacity points, that value proposition into their data center, if they're going to be running those drives for five to seven years, is huge, right? They get more power efficiency and everything else. And so, yeah, they see that TCO benefit as well driving through the product transition.

Gianluca Romano

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

A

Yeah. Tim, finally, the supply-demand dynamics will determine the price. That's a reality at the end. So, demand is fairly strong, at least in the part of the business right now. And hopefully, this will continue for a certain number of quarters in the future.

Timothy Arcuri

Analyst, UBS Securities LLC

Q

Okay. Thank you.

Operator: The next question is from Karl Ackerman with BNP Paribas. Please go ahead.

Karl Ackerman

Analyst, BNP Paribas Securities Corp.

Q

Yeah. Thank you. I'd like to follow up as well on exabyte capacity. I just was hoping you could think about or help us think about, rather, the outlook for mass capacity demand from here. You indicated that nearline, enterprise and OEM should gradually improve with stronger growth projected in the second half of calendar 2025. However, with HAMR expected to ramp in mid-calendar 2025, are you anticipating or should we anticipate any moderation in cloud demand from now until then, given the fact that September quarter will be the fifth quarter of growth of exabytes, which is a bit longer than what a typical cycle is? Thank you.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Yeah. Karl, as you know, the front end of the plunge was much more significant than anything we'd ever seen before. We had never even seen negative growth before the middle of this pandemic, right, on nearline exabyte demand. So, we started from a very weak spot. I don't think we're back to normal demand by any stretch of the imagination. But we're going to have to – like I said, because of what we've been through, we're going to be very cautious.

And did you want to say something else, Gianluca?

Gianluca Romano

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

A

I would say, of course, now we have HAMR that is in qualification right now. And in the script, we said we will have few other customers that will qualify in the next few quarters, and then we will ramp more volume. But we have, of course, many other products that we can use to answer the increase in demand between now and when we will have a significant ramp in HAMR.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Right, Karl. I mean, the BTO process gives us the visibility that we need. I don't think I would take away the middle of next year or anything else. I mean, we're going to be very aggressive on all of the products moving forward to give exabytes that way. The high volume issues, the process issues that we've seen, are really valuable learning for us, and I'm happy that the industry is all aligned at 4 terabytes and 5-terabyte value propositions that are not too far away.

So we're going to aggressively drive these introductions and be as aggressive as we can just to help reconstitute the margin in the industry. We've had a busy summer making it work, of course, but I wouldn't trade all those learnings; and as far as future ramps and future qualifications, let's go.

Operator: The next question is from Vijay Rakesh with Mizuho. Please go ahead.

Vijay Raghavan Rakesh

Analyst, Mizuho Securities USA LLC

Q

Yeah. Hi. Just a quick question on, when you look at your underutilization, I just wonder if you can give us a color on what the utilization levels are now? And how do you – does it get to like 85%, 90% exiting the year?

Gianluca Romano

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

A

So I'm not sure I got the question, but if you're talking about the level of underutilization, is not going to be any significant impact for the fiscal year 2025. So that will help our cost per terabyte, our cost in general, and is one factor on the increase of the gross margin that we expect.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Right. If it helps – the utilization generally is high, but there are various factories in the industry and the supply chain that have been pulled offline. So the question is, do we bring those factories back online, even though the utilization of the existing factories might be high than bringing new factory or some of the old factories back online is one of the questions we're dealing with.

Operator: The next question is from C.J. Muse with Cantor Fitzgerald. Please go ahead.

C.J. Muse

Analyst, Cantor Fitzgerald & Co.

Q

Yeah. Thank you for taking the question. You talked about nearline exabyte committed for all of calendar 2024. Curious how much of that have you locked in fixed pricing? And then, I guess, bigger picture question on gross margins. Now that underutilization is de minimis pushing into the second half of the calendar year, how should we be thinking about ASPs versus mix driving gross margins higher? And as part of that, as HAMR revenues start to trickle in, in September, in December, at those lower volumes, do you expect that to be accretive or dilutive? And very helpful. Thanks.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Hi, C.J. On the bookings, if you will, some of that stuff was booked, as I mentioned before, as much as a quarter ago as we started to see the demand go up. So we're fairly confident in the price and the volume that we can actually supply towards the back half of the year.

Gianluca Romano

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

A

Yeah. So I would say, all what you said will be an help to our gross margin. Of course, the pricing in the BTO, the eventual pricing that we will negotiate through the rest of the quarter and the fiscal year, now assuming demand is still growing as we expect. And, of course, also HAMR. Now, HAMR, hopefully, we will be able to ship significant volume in the next few quarters, and that will help also our gross margin to grow.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

And, C.J., you also asked a question about whether it's accretive or dilutive to gross margins. That's not exactly the way we think about it. HAMR unlocks new capacity points, of course, very quickly, and so that we will drive for that. It's a better TCO proposition, as I talked about before. There's not significant cost issues with the HAMR platforms. So I think what we can do, over time, is drive for more product efficiency, especially as we get higher and higher capacity drives, the lower capacity drives become much more component efficient, and that's exactly where we're driving the transition.

Operator: The next question is from Mehdi Hosseini with SIG. Please go ahead.

Mehdi Hosseini*Analyst, Susquehanna Financial Group LLLP*

Q

Yes. Thanks for taking my question. And I appreciate all the details. Dave, just want to go back to the long-term strategy. You guys have done a great job of resizing the company and adjusting to tough market environment, and now benefiting from pricing, and very diligent with CapEx and everything else, and HAMR is ramping middle of next year. When you think about it longer term, especially as we go through this upcycle, what are your thoughts about recapitalizing the balance sheet? What are your thoughts about longer-term earning power for the company? And is there anything that you see in the next year or so that you can do to better strengthen the balance sheet, so that we could think of the longer-term growth drivers and earning power in an environment where you're not spending \$80 million a quarter in interest expense? Thank you.

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

A

Yeah. Thanks, Mehdi. So these are questions that we're stewing on now since the last year has been so operationally focused to your earlier point, and thanks to all the accolades. I mean, it's a very, very tough year that we've been through, but we're going to have to start addressing these questions. A lot of it comes down to what ultimately the demand is, and is that demand persistent. What we don't want to do is drive our supply back up to some higher demand thing and then go through the same kind of cycle again, we just can't. We can't do that, I mean, on our financial footing. So we're going to have to address the debt. Depending on what the demand ultimately is, we're going to have to address the debt where it is. But if the demand is even higher, then we'll address that when it comes. And I think it's too early to speculate on what that is. We're still recovering from what we've just been through.

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

A

Yeah, in term of the balance sheet, we've already partially addressed the high level of debt. We enter into the downcycle with \$6.2 billion of debt. We are now at \$5.7 billion. Our liquidity is much better than what it was a few quarters ago. We were fairly open in the discussion, even in the prior quarters, we want to bring this debt down possibly around the \$5 billion. And then we see, based on where the business is, if we want to do even more or we stay at that level.

Operator: The next question is from Steven Fox with Fox Advisors. Please go ahead.

Steven B. Fox*Analyst, Fox Advisors LLC*

Q

Hi. Good afternoon. I hope you don't mind if I go back over the capacity question again. I guess I understand where you're talking about as you go through these product transitions you sort of are shipping more exabytes per head and platter, et cetera. But I guess, given that this new technology, how do we think about this transition in terms of opening up capacity over the next 12 months versus prior node transitions? Anything you can do on that to help us in modeling out three, four quarters, because I think we're all struggling with the idea, do we assume that you're in an incredibly tight environment in three or four quarters where you're getting more price, or do we assume that you're matching demand and pricing is steady? It sounds like you're adding people back already. So I'm just trying to put all that together in some kind of quantifiable manner. Thanks.

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

A

Thanks, Steve. It is a difficult math, because you have to understand exactly what the mix is of the demand that comes, right? So, if it's all highest capacity drives, that's one question. If you get a lot of mid-capacity – mid-range capacity, which is really the strength that we saw before the pandemic was mid-range capacity. And if some of that starts coming back, there's various customers that may need that. We answer the call differently for our product today, or once we drive through these transitions, we're much more efficient, right? So a lot of it will depend upon the exact mix. I think where we are right now is our thinking is do not add any drive capacity at all, just continue to be as utilized as we can and wait and see how that mix develops.

Operator: The next question is from Ananda Baruah with Loop Capital. Please go ahead.

Ananda Baruah

Analyst, Loop Capital Markets LLC

Q

Hey, guys. Thanks for taking the question. Dave, just going back to Gen AI, in the prepared remarks you talked about starting to see demand driven by Gen AI. I guess, how much – in what spirit is it starting to show up? Is it just kind of like dribs and drabs? Are you starting to see legitimate kind of chunky orders? And then, any view – like, do you have any visibility or any view on when on-premise starts for inferencing? And I guess in that context also, are the Tier 2s yet kind of "legitimate customers" [indiscernible] (52:10)? Appreciate it. That's it for me. [indiscernible] (52:13). Thanks.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

That's a pretty rich question. Let me try this, Ananda. So I think, remember, a few years ago, we talked about the cloud being in early innings. I think most of what we're seeing as far as demand right now is traditional cloud workloads, continuing to migrate to the cloud, so it's maybe middle innings, maybe still early innings for that matter.

As far as Gen AI, I think we're in the very early innings. So we can all see the efficiency of some of these new applications that are coming. But I have yet to see the big data applications really taking off. And I think they will come with video creation, video storage, video consumption at the edge, exactly to your point. More importantly, I think a lot of AI applications will need snapshotting in order to trust them. I mean, if you make a decision with an AI engine, you're going to be able to prove that that decision was the right decision by having snapshot of the data. And I think that's the biggest opportunity that we see at the edge and in the cloud. And so, we're quite excited about it, but it's still very early. We do have some purchase orders that are specifically targeted at AI, but we have not really seen how fast some of these are going to grow; and especially for the big data applications that we're really excited about, they're still in the very early innings.

Operator: The next question is from Tristan Gerra with Baird. Please go ahead.

Tristan Gerra

Analyst, Robert W. Baird & Co., Inc.

Q

Hi. Good afternoon. The focus on the HAMR has been on CSP customers, but I think you said you're now qualified with some Chinese cloud customers. How incremental is that? And how does it help move into potentially the US hyperscale market over time?

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

A

Sorry, Tristan. Yes, we said non-cloud customers. We didn't say anything specifically.

Gianluca Romano

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

We didn't even say Chinese.

A

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Yeah. The way I think about this is there's different kinds of customers that have different kind of qualifications, and also those customer architectures are more and less tolerant of certain kind of faults and things like that. We're very communicative with the customers on this. So the volume ramp has begun. It's not as aggressive as we were six months ago because of some of these volume issues that we have. But we're going to continue to ship more and more units to other people, and learn from those shipments as well. As we build volume in our factories, we'll learn about some of these supplier interactions that really slowed us down.

A

Operator: The next question is from Thomas O'Malley with Barclays. Please go ahead.

Thomas O'Malley

Analyst, Barclays Investment Bank

Hey, guys. Sorry if I missed this, I was bouncing between calls. But could you just update us on the process with the firmware update that you chose to do? I think you had previously mentioned that you had a subcomponent with a single supplier that was causing an issue, but then you used that opportunity to update the firmware. So, have you completed the firmware, I guess, requalification? And does that have anything to do with the push out into Q3? And what incremental steps do you need to take to complete the qualification from this point? That would be super helpful. Thank you.

Q

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

No, I think the test beds are up and running. The firmware, we have high confidence in the firmware qualification and we think we're over that. We're always doing firmware updates for new features for various customers, various market segments, and so on. I mean, we talked about this in the SMR details earlier. There's always architectural changes going on. So I think we're fairly confident about that.

A

Operator: The next question is from Mark Miller with The Benchmark Company. Please go ahead.

Mark Miller

Analyst, The Benchmark Co. LLC

Just wondering what your thoughts about in terms of the ramp of introduction of AI chips into PCs. Where do you see that, say, in the middle of next year as a percent of PCs with AI chips?

Q

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

This is a very interesting topic as well, Mark. From my perspective, it's time for the PC ecosystem to get some new applications, and so I'm very excited about it. I hope that some of those applications are what I'll call video editing applications. And so, then the question is, where is the data? Is it on the PC forever? Is it right next to the

A

PC? Is it in the closet in the small-medium business? Is it up in the cloud? I mean, as long as those applications are creating data and you want to store that data for a long time, I'm happy with it.

Some of the sharing may not be as rich, but I think people are going to be very creative with some of the applications that are coming. We've seen the applications in the AI PC space, but I think the adoption is still going to be slow, and I hope I'm wrong. I mean, I hope it's a little bit faster.

Operator: This concludes our question-and-answer session. I would 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, Gary, and everyone on the call. We appreciate your participation and your questions today. Hopefully, you've seen our enthusiasm for how Seagate is positioned to address the improving demand environment across all of our end markets. By continuing to focus on the fundamentals, the strong financial, and operational execution, and advancing our areal density growth road map, Seagate is well-positioned to deliver value both to customers and our shareholders, and we look forward to keeping you posted on our progress.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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