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Seagate Technology Holdings Plc (STX)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Seagate Technology Fiscal Third 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've posted our earnings press release and the detailed supplemental information for our March quarter results on the Investors section of our website.

During today's call, we will 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 are 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 on the Investors section of our website.

Following our prepared remarks, we'll open the call up for questions. In order to provide all analysts with the opportunity to participate, we thank you in advance for asking 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 is delivering solid financial results in an improving demand environment. In the March quarter, we grew revenue 6%, expanded non-GAAP gross profit 18%, and more than doubled non-GAAP earnings per share compared with the prior quarter.

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Our performance is a function of both improving end market demand and the decisive actions we implemented throughout the downturn to strengthen our financial profile heading into the recovery.

Nearline cloud demand trends are increasingly positive across both US and China customers, and we also saw a sequential improvement in the enterprise OEM markets in the March quarter.

On the execution side, the quarter-on-quarter margin expansion reflects our pricing initiatives taking hold, as well as favorable mix, resulting in revenue growth in the quarter outpacing exabyte growth.

Pricing strategy is just one key piece of our broader focus on profitability, which also includes maintaining a healthy supply/demand balance, introducing new technologies to enhance value for our customers, and maintaining tight expense controls with an emphasis on generating cash.

Looking at the near-term end market dynamics, cloud continues to lead the demand recovery. For a second consecutive quarter, we realized strong double-digit revenue growth from sales to cloud customers, with improvement across both US and global cloud names. We believe the long-running cloud customer inventory correction is mostly complete and their end demand is also improving. Based on our customer interactions, we currently expect healthy nearline demand growth to continue through the rest of calendar 2024.

Within the enterprise OEM markets, demand stabilized in the second half of calendar 2023, and we observed incremental improvement in the March quarter. Historically, enterprise nearline demand has correlated well with traditional server growth, which is projected to modestly increase in calendar 2024. As a result, we expect enterprise OEM revenue to improve as server growth resumes.

In the VIA markets, revenue was seasonally lower in the March quarter, and we expect demand to trend higher through the calendar year. Smart cities remain the largest end market opportunity for VIA products. However, new applications continue to emerge that use AI analytics to form actionable insights from data at the edge, where an estimated 80% of data resides. One such use case centers on smart energy and utility management that aims to use imaging data to drive energy efficiency and conservation. Analysts placed this among the fastest-growing sectors for VIA applications worldwide.

Within China, the pace and magnitude of demand improvement in VIA and other HDD markets will be shaped by economic recovery in the region. We continue to monitor the government's efforts to spur economic growth, including stimulus plans aimed at digital transformation and infrastructure spend. Recent economic indicators show signs of progress. However, it will take time for the benefits of these programs to take hold.

Overall, we believe these constructive market trends support steady revenue growth throughout the calendar year. Our ability to deliver that growth is enhanced by our build-to-order initiative that is now in place with the majority of large mass-capacity customers. These plans afford Seagate better demand visibility and greater predictability for capacity planning, while our customers find value in the assurance of supply that meets their volume and timing needs.

Importantly, the improving overall outlook for HDD demand is unfolding as we execute on our product and technology road map.

Today, we are simultaneously driving qualification and ramp plans for two high-capacity product families: our last PMR product delivering up to 28 terabytes per drive; as well as our first HAMR-based Mozaic product on 3-plus terabytes per disc. This is rare for our industry, and I want to acknowledge our product teams at Seagate who are

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doing a phenomenal job supporting customers as we work together to advance our industry-leading products and technologies through the various customer qualifications.

These two product families share about 95% commonality in components and leverage the same assembly processes and test processes. This enables efficiencies across areas such as procurement, manufacturing, capital investments and customer qualifications. The 24-terabyte/28-terabyte PMR drives are in qualification at most of our global cloud and enterprise customers. We have already completed qualification with one major enterprise customer, some global Tier 2 customers and with our enterprise systems business. We currently expect to begin shipping significant volumes in the first half of fiscal 2025.

Relative to HAMR technology, we continue to progress towards completing our first large CSP customer qualification, though we experienced a temporary slowdown in recent weeks. We determined a mechanical component unrelated to the HAMR recording subsystem in some of our drives was not performing as expected. We identified and rapidly implemented the solution with full support from our customer. Verification tests are underway, and these tests should be completed in the June quarter. Every other aspect of the qualification process has gone as expected.

With this shift in timing, we now expect to ship a few hundred thousand HAMR-based Mozaic drives in the June quarter and meet the remainder of our customers' exabyte demand through other already qualified products. As we gradually ramp HAMR products with our lead hyperscale customer in the second half of the calendar year, we remain focused on broadening the number of customers qualified on Mozaic products. Customer feedback reaffirms strong interest in HAMR technology, and that is further reflected in the successful completion of our first qualification with a top non-cloud customer a few weeks ago.

We've laid out a Mozaic road map with a clear path to at least 50-terabyte drives that offers customers TCO and sustainability benefits, including lower power consumption and less required floor space on a per terabyte basis. We are scaling drive capacity through areal density gains rather than adding heads and disks.

As we execute on our product road map to 50 terabytes and beyond, we expect to incur minimal changes to our bill of material costs and maintain low capital intensity of between 4% and 6% of revenue. As a result, we believe HAMR provides the path for achieving margin performance beyond our current target range as production scales, and also position Seagate well to continue capitalizing on megatrends like AI and machine learning, which drive long-term demand for cost-efficient mass storage.

As we've discussed in the past, the initial phase of gen AI has focused on building out the compute-intensive infrastructure required to develop and train large-language models. As development shifts to the deployment phase, enterprises will begin to leverage these trained AI models to transform data with value-enhancing applications and generate data-rich content. Customers expect HDD demand to increase as this phase takes hold.

Over the next several years, the volume of AI-generated content is expected to increase and also shift towards more imagery and videos, which can be up to 1,000 times larger than text. These trends bode well for HDD demand over the long-term, as HDDs remain the most cost-effective means to house and subsequently use mass-capacity data.

To summarize, the combination of more favorable demand trends, strong operating discipline, and product and technology leadership provide the foundation for driving further financial performance gains. This combination

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reinforces our confidence in returning to our long-term target margin ranges and potentially exceed those ranges over time as HAMR-based products proliferate in the marketplace.

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

Gianluca Romano

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

Thank you, Dave. Seagate delivered solid financial performance in the March quarter, with sequential improvement across every key financial metric.

Revenue was $1.66 billion, up 6% quarter-over-quarter. Non-GAAP operating income was up 44% sequentially to $183 million, leading to non-GAAP operating margin of 11% of revenue, expanding nearly 300 basis points quarter-over-quarter. And our non-GAAP EPS was $0.33, increasing $0.21 sequentially and above the midpoint of our guidance range, reflecting the improving demand trend and continued cost discipline.

Within our hard disk drive business, exabyte shipments grew 4% sequentially to 99 exabyte, while revenue increased 7% to $1.5 billion. Revenue performance was mainly driven by the expected improvement in the nearline cloud market as well as favorable pricing actions. Within the mass capacity market, revenue outpaced exabyte growth, increasing 11% sequentially to $1.2 billion with nearline cloud demand more than offsetting the slight decline in the VIA market.

Mass capacity shipment totaled 89 exabyte compared with 83 exabyte in the December quarter. Mass capacity shipment as a percentage of total HDD exabyte was 89%, reflecting the continued long-term secular growth for mass capacity demand.

For nearline products, shipment of 72 exabyte were up quarter-over-quarter from 65 exabyte. We believe that inventory among most CSP customers has decreased and anticipate continued nearline demand improvement in the June quarter and beyond.

In the VIA market, we believe the March quarter will prove to be the low point of the calendar year with demand returning to more typical seasonal patterns moving forward. Legacy product revenue was $297 million, down from $324 million in the prior quarter, primarily driven by lower seasonal demand in the consumer market.

Finally, revenue for our non-HDD business was $178 million, essentially flat quarter-over-quarter. We expect both the legacy and non-HDD market to remain at similar level in the June quarter.

Moving on to the rest of the income statement. Non-GAAP gross profit increased sequentially by $65 million in the March quarter to $432 million. Non-GAAP gross margin improved for a fourth consecutive quarter to 26.1% and expanded approximately 250 basis points compared to the previous quarter.

Continued pricing adjustment and favorable mix shift towards mass capacity products offset margin headwinds from underutilization cost which were about $43 million. Non-GAAP gross margin for the HDD business expanded much faster than overall company gross margin.

Looking ahead, we expect underutilization costs to decrease in the June quarter and abate in the second half of the calendar year as our overall build volume improves to support incremental demand in the nearline market. We believe these factors, along with ongoing expense discipline and product execution support the return to the 30% minimum margin benchmark in the current calendar year.

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Non-GAAP operating expenses totaled $249 million, up 4% quarter-over-quarter but slightly better than our guidance, reflecting the timing of certain R&D spending and continued cost control efforts. Adjusted EBITDA continued to improve and was up 29% sequentially in the March quarter to $278 million. Non-GAAP net income was $71 million, nearly tripling quarter-over-quarter, resulting in non-GAAP EPS of $0.33 per share based on diluted share count of approximately 212 million shares and a tax expense of $27 million.

Moving on to cash flow and the balance sheet. In the March quarter, we increased free cash flow generation to $128 million. Capital expenditures were down sequentially to $60 million as the majority of planned capital expenditures were completed in the first half of fiscal 2024. We expect fiscal 2024 CapEx to be at/or below the low end of our long-term target range of 4% to 6% of revenue.

We returned $147 million to shareholders through the quarterly dividend, exiting the quarter with 210 million shares outstanding. We closed the March quarter with $2.3 billion in available liquidity, including our undrawn revolver credit facilities.

Today, we announced that Broadcom has acquired our ASIC assets, including development, engineering and related IP, for $600 million in cash. The cash inlay will be reflected on our balance sheet in the June quarter and Seagate expect to use a portion of the net proceeds to support our supply chain as we begin to ramp new product builds, as well as pay down debt over time. Additionally, we expect to realize annualized OpEx savings of approximately $40 million starting in fiscal 2025. There is no expected impact to revenue.

Inventory increased to $1.2 billion as we stage material to support the continued mass capacity demand recovery, along with our concurrent ramp of our last PMR-based product and the initial Mozaic-based product ramp. Our debt balance was $5.7 billion at the end of March quarter with more than 90% of our long-term debt obligation maturing beyond three years. Interest expense were $82 million and we project interest expense to be between $83 million and $85 million in the June quarter.

Turning to our outlook. We expect continued improvement in our mass capacity market led by ongoing demand for our nearline cloud products as well as modest improvement in both the nearline enterprise and VIA market. Legacy and non-HDD revenue are expected to remain relatively flat sequentially.

With that as context, June quarter revenue is expected to be in a range of $1.85 billion, plus or minus $150 million, an increase of 12% sequentially and 16% year-on-year at the midpoint.

We are planning non-GAAP operating expenses of approximately $260 million. At the midpoint of our revenue guidance, we expect non-GAAP operating margin to improve into the low-teens percentage range including underutilization cost of approximately $20 million.

We expect our non-GAAP EPS to be $0.70, plus or minus $0.20 based on a diluted share count of approximately 212 million shares and a non-GAAP tax expense of $25 million.

Our strong expense management and supply discipline are contributing to the year-over-year profitability expansion that you are seeing in our results and outlook. Our balance sheet and healthy free cash flow generation position us well to continue supporting our capital return commitments.

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

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William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Thanks, Gianluca. Seagate is demonstrating strong operational execution and supply discipline amid an improving demand environment which sets us up well to grow revenue and further expand margins throughout calendar year 2024.

Our product portfolio, anchored by industry-leading HAMR technology, offers compelling economics for our customers and for Seagate. As we proliferate these new products, we expect to drive further financial leverage over time.

I'm confident that our product strategy offers customers the most compelling TCO proposition and positions Seagate well to capitalize on long-term demand for cost-effective mass capacity storage. We believe that the Mozaic platform delivers TCO advantages for data center operators and supports their increasing focus on conserving power and space.

This week, Seagate published our 18th Annual ESG Report outlining the progress we've made towards our own sustainability goals, including our product circularity program.

We are collaborating with customers and recovering drives from our own operations to extend these products' lifecycles and conserve the planet's limited resources. Since launching this program in 2020, we have recovered and shipped nearly 4 million drives back into the market.

Finally, I want to thank our global team members for their hard work and dedication and recognize our suppliers, customers and shareholders for your ongoing support of Seagate.

Gary, we're ready to open up the call for questions.

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QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question today is from Erik Woodring with Morgan Stanley. Please go ahead.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you so much for taking my question. I'll make it -- I'll combine this into a two-part question. So, Dave, I appreciate your comments on HAMR in the prepared remarks. Really just want to get clarification on two points, if I may. First is, have you replaced the mechanical component that was giving you an issue and then proceeded to do testing such that you won't have any further delays on HAMR, and now you're just going through kind of the final testing phase with your lead CSP customer?

And then second, I believe you've talked in the past about a goal of onboarding the remaining large CSPs by the end of calendar year 2024. Does this hiccup impact that timing at all? Or have you started the qual process with these customers? Just any clarification on those two points would be super helpful. And that's it from me. Thank you.

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

A

Thanks, Erik. Yes. Appreciate the question. So relative to the mechanical component in question, we do have other sources and we had those other sources running in parallel. So we were able to segregate the material and then get the test beds back up with the right material, I'll say it that way, and repopulate all those test beds and we recovered the schedule quite quickly because of that.

So we're not happy that we had this issue but, obviously, I think we can move on from here. And that's why we're expressing the confidence that we did in the script about completing the qualification this quarter and shipping the units.

Relative to big picture of the program, these kinds of things happen when you start to integrate high volume from all your suppliers. Sometimes, you see interactions that you didn't foresee. In long-term, this isn't going to slow us down at all and it shouldn't impact the other qualifications either. To the second point of your question, we are always reevaluating exactly where we are involved, but we want to also ramp HAMR as fast as we possibly can and get not only 3 terabytes per platter, but 4 terabytes per platter as well. So still very optimistic on that front.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you so much.

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

Amit Daryanani
Analyst, Evercore Group LLC

Q

Yeah. Good afternoon. Thanks for taking my question. I guess, Dave, I just want to focus on the cloud recovery part. In the past, I think you've talked about this being potentially a bit more gradual in nature, but certainly looking

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at your March numbers and the June guide, it would suggest perhaps the recovery is a bit more steeper. So I'm hoping when you talk to – to get a sense of – when you talk to these cloud customers, how do you think about the pace and the durability of demand recovery on the cloud side?

And related to that, I think you folks shipped close to 100 exabytes of capacity this quarter. What is the total available capacity that you have right now, and what triggered the decision to potentially add more capacity down the road? Thank you.

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

A

Yeah. Thanks, Amit. It's been a remarkable journey, I think, over the last 1.5 years, 2 years because the demand was so low relative to the supply that we had, that the industry had, and we all took, I think, some supply offline. And we started this build-to-order in earnest at least nine months ago, telling people that, hey, in order for us to actually trigger the builds, we need some predictability out of the business. And we're quite happy with how that's proceeded.

What's different in the last 90 days is that the demand really is coming back. And so, when we see the exabyte growth last quarter being outstripped by the revenue growth and then we see even more exabyte growth, then we're fairly optimistic about it. We are still not full though, to your point. We still have our utilization charges, if you will – costs and we also have factory capacity that's not fully utilized yet.

So we're going to stick to the plan, I think. The main point for us is we don't want to overbuild or build product based on speculation. We really want predictability, long-term financial health and so on. And we're happy with the improvements that have been made, but we're not quite there yet. And so, we'll continue to drive this.

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

A

Yeah. Let me add on the utilization charges. We said in the prepared remarks we do not expect underutilization charges in the fiscal year 2025. So fairly soon, we will not have that additional cost.

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

A

Thanks, Amit.

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. I know, Gianluca, you just kind of highlighted the underutilization costs. But I guess as we think about the model and you think about the recovery that you're seeing, I'm curious if we adjust for underutilization, it looks to me like you're guiding maybe a 70 basis point, again, ex-underutilization gross margin expansion this quarter at the midpoint of the guidance. How would you characterize the company's ability to price up in this environment? Especially, looking at the results, it looks like your mass capacity dollar per terabyte was up about 5% sequentially. Where are you at in that journey and how much more do you think pricing could turn favorably for the company? And really what I'm getting at is the continued driver from pricing to gross margin.

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

A

Yes, Aaron. Well, I would say, in the last several quarters, we had some success in improving our pricing, and we are continuing to do that. So part of this increase in gross margin that you are estimating for the June quarter is, of course, coming from pricing.

As you know, in the March quarter, we were very high in mix for the mass capacity. Then, when we go through the rest of the calendar year, you have other part of the business that will grow. So the mix will not be maybe as good as we had in March, but pricing is going up. And our cost, of course, is always trending in the right direction. Of course, we have a ramp of new products. But overall, we are very happy with the pricing action and where the mix is today. So we see further improvement through the calendar year.

Operator: The next question is from Wamsi Mohan with Bank of America. Please go ahead.

Wamsi Mohan
Analyst, BofA Securities, Inc.

Q

Yes. Thank you so much. Dave, if I could just go back to the qualification, any color you can share on the differences between these two qualification at your CSP and non-CSP customer? And is there a meaningful difference in the product itself between the CSP and non-CSP customer?

And if I could, for Gianluca, with this Broadcom deal that you also announced, how should we think about both the OpEx trajectory and will this impact your gross margins? So should we expect your gross margins to go down because of this slightly and then OpEx also to go down or the dynamics – what dynamics should we expect? Thank you.

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

A

Thanks, Wamsi. To your first question, there's no significant difference in the hardware. The qualification for cloud versus non-cloud, it's not usually that much different. There can be some software features depending on which cloud service provider you're talking about. That complicates the qualification and especially different customers, whether it's cloud or non-cloud, might be going through other types of architectural transitions at the time. So we have to make sure we get that right. But by and large, it's the same drive, I think that was your question.

Wamsi Mohan
Analyst, BofA Securities, Inc.

Q

Right. Yes.

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

A

So, on the financial impact for the transaction with Broadcom, the major difference will be in OpEx where we expect a decline of about $40 million for fiscal 2025. We have a very good collaboration with our partners. So, we don't expect basically any other change from operations. So it's mainly a reduction in OpEx due to transfer of asset and people to our partner.

Wamsi Mohan
Analyst, BofA Securities, Inc.

Q

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Okay. Got it. Thank you so much.

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

A

Thanks, Wamsi.

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

Krish Sankar
Analyst, TD Cowen

Q

Yes. Hi. Thanks for taking my question. I had a question for Dave or Gianluca, a two-part HAMR question. Dave, you mentioned you might ship a few hundred thousand units of HAMR this quarter. Kind of curious how to think about the HAMR unit shipment in the second half of this year or exiting 2024, how many units do you think you can ship?

And just as a follow-up to that is, you mentioned about the gross margin exceeding the range longer term, I'm kind of curious as HAMR drives become more mainstream, say, a couple of years from now, do you think your gross margin can be over 40%? Thank you.

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

A

Yeah. Thanks. We will continue to ship aggressively and go through the HAMR transition largely because we think it provides better value to our customers, higher and higher capacity points. And then ultimately, over time, it allows us to get components out of the chain which saves cost against these platforms as well.

I mean, we're in an interesting position right now because, say six months ago, I think supply was ahead of demand and now supply is lagging demand. Some of that's just lead times on the product. So balancing all these things is very important, I think, in today's market, but we're still going to drive very aggressively through the transition. And we do believe that this is the way to get more margin into our business as well.

So I won't go into specific numbers as we qualify customers because, right now, customers are seeking any kind of product that we can actually make which – and we may actually turn our turnover to some products that are already qualified versus prior plans we were driving. But I view that as a good thing because now we actually have demand that's helping our factories, that's getting us focused and so I'm very optimistic about that. But just so we all are very clear, we're going to continue to drive the transitions very aggressively.

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

A

On the gross margin trajectory, we said before, we expect to be at 30% or higher during this calendar year. And as you know, there is only a part of the ramp of HAMR. So for sure when we move higher volume of HAMR, we expect to be in the high part of the range or even higher. We will see in that point of the ramp. But, yes, even without HAMR, we can be into the 30% to 33% range that we discussed is our target in the past.

Krish Sankar
Analyst, TD Cowen

Q

Thank you.

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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. Dave, I was wondering if there's any more color you can provide on your experience with talking to customers about build-to-order plans for, say, the next 12, 24 months. I mean, it sounds to me like you have accelerating demand on the cloud side, legacy and VIA sort of recovering on a seasonal type of basis. And then you have channel partners that are going to need inventory in order to help even things out. So how are you balancing all that? What is going to be different do you think that we should consider if we're looking out over the next few quarters with how you're going to be doing business? Thanks.

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

A

Yeah. Steven, I think it's a really good question because I think it goes back to what we've just been through, living through this downturn, one of the key lessons was just the sheer amount of supply chain inertia that we had can create problems when the demand stops so quickly. And so we need to be a lot more diligent. I mean, we can't have volume shipments, exabyte volume shipments where the revenues for underrunning the exabytes.

And I think part of what we can control is control the builds. And make sure we don't overbuild and make sure we're not trying to push stuff into the market especially when the market is soft. Now that it's a little bit stronger, exactly to your point, which is a nice trend in the last 90 days that we're really encouraged about, then we can go back and say, okay, which ones will we actually build more for, and we're having those conversations with the customers.

But again, we want to come back to predictability is the overarching objective here. And we'll also reward customers who give us that predictability with the best financial outcome for themselves as well. So having those negotiations is giving us pretty good visibility into what's coming over the next three or four quarters, and I'm happy with that.

Steven B. Fox
Analyst, Fox Advisors LLC

Q

That's helpful. Thank you.

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

Timothy Arcuri
Analyst, UBS Securities LLC

Q

Thanks a lot. I wanted to ask about this million HAMR unit that you had guided for the first half of the year, mostly it was going to be 30 key drives. So you're going to make up it sounds like 700,000, 800,000 drives with other stuff beyond HAMR.

But I had kind of two questions. One, you probably have to rework some of the HAMR WIP. So that would be a negative, but it did seem like HAMR was going to be dilutive initially. So is that all kind of a net positive for June quarter gross margin? And then because you gave us this – sorry, go ahead.

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

No. You go ahead and finish your question, Tim.

Timothy Arcuri
Analyst, UBS Securities LLC
Q

Yeah. So I just was going to ask, since you gave us that 1 million unit number, I'm curious if you can give us some indication of what you think units will be in the back half of the year for HAMR. Thanks.

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

Yeah. There's two aspects of this. One is the completion of the timing of the qualification and then the other is the total amount of material. And remember, we said we have other sources for the particular component. So we don't have to segregate the entire WIP. There's parts of the WIP that are still moving, right?

But I think the timing of the qualification is really the issue there. We're not going to get into how many we're forecasting for the back half of the year because a lot of that will depend on specifics of demand from customers and when the rest of the qualifications time out.

But from my perspective, once we get that material segregated, yeah, is there some rework or scrap to do, yeah, but I think we can take that. And keep in mind that all of these products are common with one another. So we have homes for other materials if we want to. It can be pivoted from the 24-terabyte/28-terabyte family up to the Mozaic family as well. So, I think we have a lot of flexibility there.

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

And just a clarification, Tim, on the HAMR gross margin, we never said that HAMR was dilutive to gross margin. We said that HAMR gross margin will, for sure, improve in the second part of the ramp, not the first part of the ramp, has of course a little bit more cost, but we never said it was dilutive to our overall gross margin.

Timothy Arcuri
Analyst, UBS Securities LLC
Q

Right. Okay. Thank you, Gianluca.

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

Thank you.

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

Karl Ackerman
Analyst, BNP Paribas
Q

Yeah, thank you. I wanted to get a better understanding of the demand impact of both the ramp of 28-terabyte SMR and the simultaneous ramp of 32-terabyte HAMR, which might be 34-terabyte, 35-terabyte SMR. I'm

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curious, whether you see that as perhaps somewhat cannibalistic to your early deployments of HAMR? If you could just discuss that, that would be great. Thank you.

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

A

Yeah. Thanks, Karl. Different customers have different requirements and different feature sets, how they use the drive. And so, I don't think there's a one-to-one swap. I mean, the good news for us is we have a lot of commonality, and so we can react fairly quickly as to whether more people want one family or the other. But we're working with a lot of people on, as I said in the prepared remarks, on two different qualifications at the same time.

And as far as I'm concerned, the qualifications are going well. We're staying very communicative with the customers. And against a demand environment that's improving, I think that's why they should value our predictability even more as we show them what we have and what we're willing to build.

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

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Yeah, yeah. Good afternoon, guys. Thanks for taking the question. I guess just one on gross margin. In the past, when you had dynamics similar to the demand ramp, price increases, and then, Dave, supply-demand tightness, there is typically been a quarter or so where you can get pretty pronounced step-ups in gross margin. And just wondering if there is anything that will preclude this cycle at some point from having the same type of dynamics?

And then, just to sort of sneak one in there real quick. Gianluca, any updated metrics – you've given metrics in the past about revenue to gross margin kind of scale ratios. Do those still hold, the ones that you've been giving, or does the pricing dynamics here changed that all? Thanks, guys.

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

A

Thanks, Ananda. I'll let Gianluca answer his part. But I guess what I'd say at a very high level is that we're going to continue to push aggressively through product transitions, because we think that's the best way to continue to add value to our customers and margin for ourselves. Some of the margin uplift that we're seeing right now is obviously because of the factories being – they are filling up. They are not completely full yet, but they are filling up, and that's a good sign.

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

A

Yeah. On the trajectory, especially with gross margin, but the business in general, every cycle is a bit different. We are saying today we see a good recovery from the cloud part of the business. Of course, it's not all the business increasing at the same way. So we still need to wait for other segments to start having the same kind of recovery before we can see a strong upside. But no, we are very positive. We said earlier, we see that gross margin improving quarter-over-quarter and to be in the target range during this calendar year. I would say, every quarter, we have little bit better pricing, a little bit better cost. So the opportunity for us to achieve that target range at even lower level of revenue is for sure a reality.

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Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Cool. That's super helpful. Thanks, guys.

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

A

Thanks, Ananda.

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

A

Thank you.

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

Mehdi Hosseini
Analyst, Susquehanna International Group

Q

Yes. A couple of follow-ups from me. I was under the impression that for most of your components, you have gone insource. So what is it with HAMR that has made you rely on external vendors and how you're switching these vendors?

And one follow-up for Dave. What is your most updated overall exabyte growth looking forward as the cycle gains momentum? Thank you.

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

A

Yeah. Thanks, Mehdi. For our critical components, we are largely insourced, but, again, this is a mechanical piece part that is not something that we make ourselves, it's something that we source from the outside and it's very common in all product families. So just for that clarification.

And Gianluca, do you want to take the second part?

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

A

I was just thinking about the components, but we have many components that we source externally, actually, the head, the media, of course, we produce internally and those are the most critical components, but there are many other components that we get from external suppliers. And on that particular component, we have multiple sources, so we can switch from one to the other.

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

A

Yeah. And then, on exabyte growth, Mehdi, I think it's a good question because we had come out of negative and we know that that's not real. The negative was the first time in the history of the industry that we'd ever seen something like that. So I do expect things to start expanding. And we get into this discussion about whether we like 35% or 25%, we back down to 25%. Maybe near term, we're going to see something a little bit more expansive. It's still early in this demand cycle, but we're fairly encouraged by what we're seeing. And I think also

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our ability to go answer that with these new products, which provide more exabytes, may actually drive even more exabyte expansion.

The key point right now is we want to make sure that we reestablish the financial predictability of our industry because the industry's been so damaged of late. I think as we grow back, we have to make sure we're not giving the stuff away, that we're doing it in a way that's very measured. And the only way we can do that right now and it's the only way that makes any financial sense, too, is to make sure we control supply very tightly.

Mehdi Hosseini
Analyst, Susquehanna International Group

Q

Thank you.

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

C. J. Muse
Analyst, Cantor Fitzgerald & Co.

Q

Yeah. Good afternoon. Thank you for taking the question. I know you talked about the qualification just being a three-month delay and qualifications elsewhere on track. But if things do push out a bit, how do you, I guess, expect to maybe impact your planned utilization elsewhere, your thoughts around pricing and mix? And what kind of impact could that have? I would think positively on gross margin in the back half. Would love your thoughts though.

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

A

Yeah. Thanks, C.J. And the interesting thing is as demand comes back, we have much more flexibility than we did, say, six months or a year ago. We, in this build-to-order process, we've basically told people what we're going to build, and then they've said, okay, I understand the economics. So, as more demand comes, we can now have a new discussion with them and say which product is qualified, which one do you want to hurry up and qualify. And so, I think we have a lot of options there.

I mean, we've been focused on operating profit and free cash flow. And we're finally back in double-digits on operating profit, and ROIC is finally turning back up. So, all of this is just reinforcing the strategy to keep running the business for long-term predictability of this build-to-order things working, and I think we're going to stay on it.

C. J. Muse
Analyst, Cantor Fitzgerald & Co.

Q

Thank you.

Operator: The next question is from Toshiya Hari with Goldman Sachs. Please go ahead.

Toshiya Hari
Analyst, Goldman Sachs & Co. LLC

Q

Hi, thanks for taking the question. Dave, in your prepared remarks, you talked a little bit about AI. I realize you don't have perfect visibility into what's driving customer demand. But I'm curious, based on your conversations with your customers, to what extent is AI having impact on your business? I know it's nascent, but if you can comment on that, that would be great.

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And then related to that, I was hoping you could opine on your ability and the broader HDD industry's ability to compete with Flash and AI. I think based on recent conversations, some of the concerns that investors seem to have is that hard disk drive, you're very cost-competitive. But when you take into consideration things like read-write capability, space, and power consumption, it might be a little bit more competitive vis-a-vis what you're shipping today. So, curious if you can opine on that. Thank you.

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

A

Thanks, Toshiya. So, yeah, AI is a big question, and I know it's confusing for a lot of people because there's so much marketing around it. I do think that cloud service providers, even the enterprise OEM customers that we have, they have many different types of applications. And some of those application spaces continue to grow. Some of those applications are being dramatically transformed right now by the new compute capabilities that people have and so on.

And what I would say in general is that there are applications that are definitely, I'll call it, cold storage, colder storage, or big data applications that are coming, video applications for example, that we are very encouraged by. And we are seeing purchase orders now from cloud service providers and so on that actually say AI on them, which wasn't true six months ago. But given all the creativity in this application space, I'm really excited about it. I think there's a lot of opportunity there for us.

Relative to our ability to kind of pivot for where we need to go, I think we're going to keep driving mass capacity, for sure. We are working a little bit on performance in our tiers. And then Flash, I'm going to say, I usually don't opine on this very much, but I don't have very much bad to say about Flash. I think it's a great technology. I think it's going to be critical for Flash to execute in their layers to enable their applications. Some of those applications may have nothing to do with mass capacity. But this idea of mass capacity being in conflict with Flash, I don't think is right. I don't think that's the way architects think about it in data centers. I don't think that economically it makes sense.

And even when you get into things like power and space, I think hard drives are going to stay very, very competitive on the workloads that they offer. So from my perspective, the new application space is exploding is a good, good thing and it should benefit a lot of hardware providers over time. We've all been through a pretty rough patch of late, and we've got to make sure that we watch our supply into it because we can't tolerate another dramatic downturn like we just saw. So we've got to be very careful.

Toshiya Hari
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

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

Thomas O'Malley
Analyst, Barclays Capital, Inc.

Q

Hey, you guys. Thanks for taking my question. I just want to understand the ramp with your largest customer in HAMR. You talked about this subcomponent and you are replacing that subcomponent. Is that – you're saying multiple vendors are getting qualified at the same time. So if you look at what a step back traditionally takes in terms of having a customer qualify a product, is that several weeks, is that several months? I guess, what gives

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you the confidence that with this step back that you'll be able to not only qualify, but then ship these drives within the quarter? Thank you.

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

Yeah. So, Tom, we already said that there's multiple sources for this. And so, we segregate the parts that were affected and then we push the other ones on their merry way. We've already repopulated those test beds that are running well. So, that's why we have confidence.

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

Okay. And so in the future, you will just not use that supplier anymore? Or you would just rely more heavily on the others? Yeah.

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

Oh no, no, no, I wouldn't say it like that. I mean, we'll go work with everybody. Everybody's got a tough challenge. They have issues, and we'll go work with them. Yeah.

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

Helpful. Thank you.

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

Thanks.

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

Oh, thanks, Gary. As you heard today, Seagate's well-positioned to drive improved financial performance in a recovering demand environment through ongoing operating discipline, keen focus on supply-demand balance, which is a big deal, and ramping our latest CMR, SMR, and HAMR-based products.

I'm confident in our product strategy, I think it's serving us well, and in our HAMR technology, which positions Seagate well to capitalize on long-term demand for cost-effective mass-capacity storage. I'd just close by thanking our stakeholders for their ongoing support. Thanks for joining us today, and we look forward to speaking with you during the quarter.

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

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