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NTAP.OQ - Q1 2027 NetApp Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good day and welcome to the NetApp first-quarter of fiscal year 2027 earnings call. All participants will be in listen-only mode.

(Operator instructions)

Please note this event is being recorded. I would now like to turn the conference over to Kris Newton, Vice President, Investor Relations. Please go ahead.

Kris Newton - *NetApp Inc - Vice President, Investor Relations*

Hi, everyone. Thanks for joining our Q1 FY27 earnings call. With me today are our CEO, George Kurian and CFO, Wissam Jabre. This call is being webcast live and will be available for replay on our website at netapp.com.

During today's call, we will make forward-looking statements and projections with respect to our financial outlook and future prospects, including without limitation, our guidance for the second-quarter and fiscal year 2027, our expectations regarding future revenue profitability and shareholder returns, the expected benefits from our acquisitions and partnerships, and other growth initiatives and strategies.

These statements are subject to various risks and uncertainties, which may cause our actual results to differ materially. For more information, please refer to the documents we file from time to time with the SEC and on our website, including our most recent Form 10-K and Form 10-Q. We disclaim any obligation to update our forward-looking statements and projections. During the call, all financial measures presented will be non-GAAP unless otherwise indicated. Reconciliations of GAAP to non-GAAP measures are available on our website.

I'll now turn the call over to George.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

Thanks, Chris. Good afternoon, everyone. Thank you for joining us today. We delivered a stellar start to the year, exceeding our Q1 guidance on every metric and delivering a record-setting first-quarter. Revenue increased 30% year over year.

To $2.03 billion. Our disciplined approach converted robust top-line growth into significant profitability, even in a challenging component cost environment, with gross profit growing 29% to a record $1.43 billion, operating margin reaching 31.9%. And EPS up 66% from Q1 a year ago. Adjusting for the additional week in Q1, our performance still stands as one of the best in the company's history. This quarter's achievements reflect more than just strong execution. They underscore NetApp's growing leadership in a rapidly evolving environment. Our broad-based success.

Expand industries and geographies with multi-year agreements, expansion into new workloads, and deeper customer engagement, all strong leading indicators of durable growth. While we're seeing some accelerated purchase decisions and pricing benefits, we are also seeing a clear structural improvement in the underlying demand environment.

All of which contributed to Q1 strong results and are fueling our momentum. This exceptional quarter is both a testament to our execution and a clear signal of the expanding opportunities ahead. Given our strong start and the success we're seeing across our business, we are materially raising our outlook for the year.

AI is no longer a future aspiration. It's a business imperative. As organizations move to operationalize AI, the challenge is not just compute, but data readiness. NetApp is a key partner for companies making this shift, eliminating complexity and accelerating time to value at scale. The NetApp platform enables customers to make all data.

AI-ready in place, providing unified storage, robust security, and a single control plane across hybrid multi-cloud environments, delivering capabilities that redefine expectations in the industry. By removing the need for data movement, we empower enterprises to accelerate AI and analytics while maintaining governance and control. Enabling them to transition from AI experimentation to production with confidence. The strength of our platform is fueling both deeper relationships with existing customers and new customer acquisition. A recent win highlights this momentum. In a highly competitive evaluation, a major US utility chose NetApp.

Over both legacy and flash-only competitors, displacing the incumbent and standardizing on our unified AI-ready data infrastructure. Wins like this, where a customer entrusts their most demanding workloads to NetApp, are leading indicators of our expanding role in the market and set the stage for long-term growth.

Our record Q1 was fueled by robust growth in public cloud, all-flash, and Keystone revenues, reflecting the momentum in our business and validating our strategy as we deliver meaningful results for customers. Driven by strong adoption of our first-party and marketplace storage services, Q1 public cloud revenue grew to $206 million. Up 28% year over year and up 19% adjusting for the extra week. Customers choose NetApp for our secure, scalable cloud native storage services as they migrate workloads to the cloud. VMware workloads in particular are among those increasingly being moved to the cloud, opening significant opportunities for NetApp.

In Q1, a US hospitality company adopted NetApp technology for the first time through Amazon FSx for NetApp ONTAP, supporting its large-scale VMware migration to AWS. FSxN delivered superior performance, lower costs, and versatile workload support.

Similarly, a US public sector organization selected Azure NetApp Files as a part of its data modernization efforts. ANF overcame technical barriers found in other cloud services and enabled substantial cost savings. These wins highlight how NetApp's differentiated cloud storage solutions facilitate seamless, efficient VMware migrations. Reinforcing our ability to drive sustained growth as organizations accelerate their cloud adoption. All FlashArray revenue reached $1.31 billion in Q1, up 47% year-over-year.

Customers are standardizing on NetApp for their most mission-critical workloads, including. GPU-intensive AI pipelines that demand high performance, low latency, and built-in cyber resilience. Our innovation and go-to-market execution continue to drive share gains in this part of the market. In today's challenging cost environment, the breadth and flexibility of the NetApp platform stand as strategic advantages.

We empower customers to optimize performance, capacity, and budget requirements without compromising cyber resilience or operational simplicity. This value proposition is driving strong customer demand across our portfolio, and notably, we are seeing accelerating interest in our hybrid flash solutions.

Let me share recent examples of how the breadth of our portfolio has enabled us to displace competitors and win new customers. In its first engagement with NetApp, a European IT service provider for pension insurance selected our unified storage to meet stringent security and resilience requirements for critical infrastructure.

Our flexible architecture not only supports the availability and integrity of highly sensitive data today but also provides a secure, efficient, and sustainable foundation for future AI workloads. NetApp recently displaced a competitor at a leading transportation agency. Our solution combined. All-flash arrays for high-performance processing of massive video files with hybrid flash arrays for reliable, cost-effective long-term retention. Our ability to deliver the scalability, reliability, and performance required for advanced analytics and ongoing infrastructure maintenance was key to the win.

AI is powering a new wave of growth for NetApp, momentum that has been building and continues to accelerate. In Q1, we won approximately 350 AI and data lake modernization deals, up significantly from a year ago. Importantly, deal sizes are increasing as customers move from proof of concept to production.

Initial wins in prior years are expanding into production level workloads, reflecting confidence in NetApp's ability to support large-scale AI environments. Our solutions are enabling customers to activate data in place for AI, accelerate time to insight, and achieve real business outcomes, putting NetApp at the center of their AI journeys.

Here are a few examples from Q1. We signed a significant agreement with Samsung Electronics to support its EDA environment and AI Center of Excellence. A public sector organization awarded NetApp a strategic deal to modernize and expand its intelligence capabilities and deliver real-time analytics. Leveraging NetApp AFX integrated with NVIDIA SuperPOD. AFX's disaggregated architecture provides the flexibility and performance required for advanced AI workloads and provides a future-ready foundation, delivering the power and scalability needed to meet evolving requirements as data demands grow.

NetApp secured a significant win with an Asian neo-cloud provider, supplying high availability, secure, and scalable storage for new customer-facing AI services. Our robust multi-tenancy and deep expertise in large-scale Kubernetes and OpenStack environments set us apart. Helping the provider to modernize its infrastructure and support demanding AI inference workloads. This win displaced existing vendors and established a strong foundation for NetApp in one of the providers' most strategic AI initiatives. We are strengthening our leadership through strategic acquisitions that expand the capabilities of the NetApp platform and broaden our addressable market.

These investments position us to stay ahead as customer needs evolve, deepening our differentiation in cloud and AI. In Q1, we acquired Data Pelago, a recognized innovator in AI data infrastructure. Their Nucleus software engine enables high-performance in-place data processing. Eliminating costly data movement, and streamlining AI readiness. With this technology, we believe we can unlock additional value from the vast unstructured data already managed on our platform, giving customers fresh opportunities to accelerate their AI initiatives and maximize the potential of their existing data assets.

This positions NetApp as the company that makes zero copy activation of enterprise data for AI real, helping customers drive AI initiatives, improve efficiency, and unlock more value from their data. At the start of Q2, we acquired Jetstream, a leader in cloud-native disaster recovery for VMware environments.

Jetstream enables continuous protection and recovery of VMware workloads across diverse storage environments with seamless replication to NetApp cloud offerings like Azure NetApp Files. This acquisition will allow us to offer a simpler, more flexible path to cloud modernization and positions NetApp as the recovery destination of choice for VMware deployments.

Even when production data originates from competitors' infrastructure. NetApp's strong Q1 results underscore our leadership in a transformative era shaped by accelerating AI and cloud adoption. The strength and flexibility of the NetApp platform allow us to support a diverse and growing customer base. By winning new business, deepening partnerships, and investing in innovation, we are building a durable foundation for continued leadership and long-term growth.

We are executing with discipline and vision and building on our leadership to deliver sustained value for our customers and shareholders. We are excited to host our annual customer conference, NetApp Insight in September.

We will showcase substantial innovation throughout the NetApp platform, delivering new value for AI and addressing the unique needs of high-growth markets like Neo and sovereign clouds. We also will host an investor session to provide more detail on our strategy and solutions, and we hope you will join us. In closing, I want to thank our employees for their dedication and focus. Our record start to the year is a testament to our team's commitment to our customers and to driving NetApp's continued success. I'll now turn it over to Visam.

Wissam Jabre - *NetApp Inc - Chief Financial Officer, Executive Vice President*

Thanks, George, and good afternoon, everyone. In the fiscal first-quarter, we delivered exceptional results, exceeding the high end of all our guidance ranges. Revenue for the quarter was $2.03 billion, up 30% year over year. And 4% sequentially. Non-GAAP earnings per share was $2.58, up 66% year over year. Revenue growth was driven by broad-based momentum across the business, highlighting the strength of our portfolio.

This quarter's results reflect a healthier demand environment as customers invest in AI and modernization, as well as some accelerated purchases and pricing benefits. As a reminder. Q1 included an additional week. Revenue was up 26% year over year, excluding the effect of the extra week, which contributed approximately $65 million to revenue, primarily in support and public cloud.

Looking at revenue by segment, hybrid cloud revenue of $1.82 billion was up 30% year over year and 27% adjusting for the additional week. Product revenue of $987 million was up 51% year over year. Support revenue of $720 million was up 11% year over year and up 4% excluding the extra week, which contributed approximately $50 million. Professional services revenue of $112 million was up 15% year over year, mainly driven by continued robust growth in Keystone. Our storage as a service offering.

Q1 public cloud revenue of $206 million was up 28% year over year and up 19% adjusting for the extra week, reflecting strong demand for first-party and marketplace storage services. The additional week contributed approximately $15 million to public cloud. We exited Q1 with $4.85 billion in deferred revenue, an increase of 7% year over year. Remaining performance obligations were $5.65 billion, up 14% year-over-year.

Moving to the rest of the income statement. Please note my comments will be related to non-GAAP results unless stated otherwise. Q1 gross margin was 70.6%, exceeding the high end of our guidance and down 50 basis points year-over-year, driven by greater product revenue mix compared to a year ago. Product revenue in the quarter was 49% of total revenue, compared to 42% in the same period last year.

The headwind from revenue mix was partially offset by year-over-year gross margin expansion across product, support, professional services and public cloud. Gross profit was $1.43 billion, up 29% compared to Q1 2026. Hybrid cloud gross margin was 68.8%, down 20 basis points sequentially, reflecting lower product gross margin and partially offset by improvement in support and professional services gross margin. Product gross margin was 54.6%, down 150 basis points sequentially, mainly driven by higher component costs and partially offset by better pricing.

Our recurring support business continues to be highly profitable with gross margin of 93.2%. Professional services gross margin was 36.6%, improving 4.5 percentage points sequentially. Public cloud gross margin was 86.4%, up 70 basis points sequentially and over 6 percentage points year-over-year, benefiting slightly from the additional week. The public cloud business has operated above the high end of the 80 to 85% long-term target range in the past three quarters.

Operating expenses of $784 million were up 11% year over year and 5% sequentially, driven primarily by variable compensation and the impact of the additional week, which added approximately $22 million. Operating income was $645 million. Up 61% compared to Q1 2026, and operating margin was 31.9%, up 6.1 percentage points year over year.

Earnings per share exceeded the high end of the guidance range at $2.58, up 66% year over year, more than double the growth rate of revenue, highlighting the operating leverage and our ability to translate that into earnings power.

In Q1, cash flow from operations was $503 million and free cash flow was $401 million. During the first-quarter, we returned $302 million of capital to our shareholders with $200 million in share repurchases and $102 million paid in dividends of $0.52 per share. Q1 diluted share count of 200 million decreased by 3 million shares. Or 1.5% year-over-year. Our balance sheet remains very healthy. We closed the quarter with $3.6 billion in cash and short-term investments and $2.5 billion in gross debt outstanding, resulting in a net cash position of $1.1 billion.

Inventory expanded both year-over-year and quarter-over-quarter as we managed supply and inventory levels to support growing demand. Inventory turns were six, down sequentially. Overall, Q1 was an excellent start to the fiscal year, highlighted by strong revenue growth amid heightened AI and cloud-driven storage solutions demand. Combined with our disciplined execution, our revenue growth drove meaningful operating margin and EPS outperformance and robust cash flow generation.

Now turning to non-GAAP guidance, starting with Q2. We expect revenue to be $2.1 billion plus or minus $75 million. At the midpoint, this implies 23% year-over-year growth. We expect gross margin to be in the range of 67% to 68%, sequentially lower primarily driven by higher product revenue mix as a percentage of total revenue. We expect operating margin to be in the range of 30.9% to 31.9%.

We expect earnings per share to be in the range of $2.54 and $2.64 with a midpoint of $2.59. Turning now to full year fiscal 2027. We remain confident in the strength of our portfolio and our ability to execute in the current environment. Strong demand and continued business momentum reinforce that confidence and support our increased outlook for the year. We are raising our fiscal year revenue and EPS guidance.

We now expect fiscal year 2027 revenue to be in the range of $7.975 billion to $8.225 billion. At the $8.1 billion midpoint, this represents 17% year-over-year growth and an increase of $650 million compared to our prior guidance. We expect gross margin to be in the range of 68.1% to 69.1%. The revised range primarily reflects a higher expected mix of product revenue compared with our prior guidance.

At the same time, our fiscal year 2027 product gross margin expectations have improved slightly, while the underlying gross margin outlook for the rest of the business remains largely unchanged. We are raising operating margin to be in the range of 30.3% to 31.3%. We are raising earnings per share to be in the range of $9.73 to $10.03. At the $9.88 midpoint, this represents 22% year-over-year growth.

In closing, as we look ahead to the rest of fiscal year 2027. We remain confident in our strategy and disciplined execution. Our focus stays firmly on delivering strong revenue growth and profitability, strengthening free cash flow, and building long-term value for our customers and shareholders.

With that, I'll now turn the call over to Chris for Q&A.

Kris Newton - *NetApp Inc - Vice President, Investor Relations*

Thanks, Wissam. Operator, let's begin the Q&A.

QUESTIONS AND ANSWERS

Operator

We will now begin the question-and-answer session.

(Operator instructions)

Joseph Cardoso, JP Morgan.

Joseph Cardoso - *JPMorgan Chase & Co - Analyst*

Hi, good afternoon and thank you for the question. Maybe for my first, if I could, George, you called out accelerating purchase decision and pricing benefits as well as structural improvement and underlying demand at the same time.

Can you maybe just walk us through the key drivers that is helping you distinguish between those dynamics and what drives your confidence around maybe the more durable demand part of that? And just particularly in the context of the outlook, which implies the decline in heading into the second-half of the fiscal year, and then I have a follow-up.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

Thank you for the question. We had an exceptional start to the year. The demand profile was broad-based and we saw strength across every customer type by size, medium, small, public sector. We saw it across all the geographies and we saw it across industry verticals, workload solutions, on-prem, Keystone, cloud, so super strong. Broad-based portfolio strength.

I think when we distinguish the three buckets, clearly what we saw in the quarter was counter to what we see typically when prices of silicon and commodity costs go up dramatically. Customers generally lean into tech refresh, we saw into maintenance and non-refresh, we saw the opposite, we saw much higher than the anticipated strength across all classes of customers. Within the largest customers, we saw some pockets of accelerated purchasing.

But in many of those customers, we also saw them for less priority workloads and use cases be more moderated in their buying behavior as is typical. And then we saw clearly as commodity prices have gone up, we have adjusted our pricing and you could see that in the outperformance in our product gross margin relative to. Our guidance, which is reflected in our ability to capture higher pricing.

Joseph Cardoso - *JPMorgan Chase & Co - Analyst*

No, got it. Thank you, George. I appreciate the color there. And maybe just a quick follow-up on the last comments you made. Just wanted to get an update or a clarification on how you're thinking about I think you believe I believe you guys called out product gross margins troughing in the first-quarter itself. Is that playing now? And then maybe more specifically, are you realizing the full benefits of the flow-through of the pricing actions you've. And whether that's already play now in 2Q or should we expect that to still be a tailwind going out into the 3Q or one of the subsequent quarters. Thanks for the questions, guys.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

Yes, great question. And so in Q1, we did outperform our expectations with respect to the product gross margin, as George mentioned. We did have a bit of a favorable product mix associated with the various customer types and the geos that we serve, and so it did help us a little bit.

As we think and we look forward to Q2 and the rest of the year, the outlook very much on product margin. Has improved slightly relative to our prior guidance that we provided 90 days ago and so that's sort of an incremental positive, which basically says we have a bit more confidence in our ability to recoup the incremental costs that we're paying.

Albeit, probably it won't be at the same levels we saw in Q1, but I would stress that it would be we're anticipating and projecting it to be better than we thought it would be 90 days ago for the rest of the year.

Operator

Mehdi Hosseini, Susquehanna Financial Group.

Mehdi Hosseini - *Susquehanna Financial Group LLLP - Equity Analyst*

Yes, I also have a question with two parts. Georgia, help to understand how would you. Break up your customers' investment and splitting modernization, upgrade of existing install base of storage from incremental capacity added due to AI inferencing. And my second question is for Vissam. I'm a little bit confused with the product gross margin trajectory. I think expectation was for gross margin, product gross margin to.

Be trotting in the mid-50% and improve from there. But your Q2 guide implies that we actually may see Q-over-Q decline. If you could clarify, it would be appreciated. Thank you.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

With regard to your first question, Mehdi, we have seen super strong growth in our product portfolio as well as offerings like our all-flash arrays, Keystone and our cloud storage. Pretty much across the board, we were well ahead of our expectations. And we continue to see that strength durable for multiple quarters, which is why one quarter into the year, we have raised the full year materially, including the second-half, right? So really strong momentum in the business.

With regard to what we saw, there are AI-specific build-outs, which are, for example, GPU-as-a-Service clouds, GPU environments within enterprises, and data lakes and modern data lake type environments being built particularly for GPU usage and for AI. Analytics.

There is, however, also, as other people have noted, including the hyperscalers, a broad-based modernization of a variety of adjacent workloads and infrastructures, right? So when you use AI, you also want to modernize your databases. You also want to modernize your unstructured data environment to get them ready. And we saw that happening pretty much across.

All the industries and all the customer segments, so really strong momentum. We're excited for the year, super confident about our position in the market and the alignment to where customers are prioritizing spending.

Kris Newton - *NetApp Inc - Vice President, Investor Relations*

And to the second part of the question, Mehdi, look, we did anticipate so so maybe I'll explain how we anticipated the product gross margin to be shaped throughout the year 90 days ago. We said that we would see a trough in Q1 and we anticipate a slight improvement for the rest of the year or gradual improvement for the rest of the year.

Now fast forward to today, we did manage Q1 product gross margin in a really great way. I think we did a great job in execution and we outperformed our expectations for Q1. So that's sort of the first point I want to make. The second point is when we compare now Q2 to Q4 for the rest of the year to where it was 90 days ago, we're now expecting it to be slightly better. So if you think of the prior guidance had product gross margin in sort of the low 50% range if you sort of even though we don't guide every number, but that's what I was implied in the guidance.

What's implied now in the updated guidance for the rest of the year in product gross margin is slightly better than that. That's really the hopefully that clarifies and answers your question.

Operator

Amit Daryanani, Evercore.

Amit Daryanani - *Evercore Inc. - Equity Analyst*

Thanks a lot, and good afternoon. I guess just two questions from my side as well. I think one of the big things that investors are trying to figure out is just the durability of growth that you and everyone else are seeing. And if I think about your fiscal year guide, you folks are going to do 26% growth in Q1 X extra week, it's going to 23% in Q2, and I think it's like 9% or 10% in the back half of the year. Can you just talk like what is driving that sort of deceleration? And is that exit rate in the back half of 9%, 10% sort of the right way to think about what the. Should be for the company?

And then, George, you sort of talked about using clear structural improvement in the underlying demand environment. Can you maybe just help us appreciate like what metrics are you looking at or tracking to give you confidence that this is a structural shift versus perhaps pre-buying given all the price increases? Thank you.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

I think, first of all, we are one quarter into a fiscal year. And our approach has been to provide guidance that we feel confident about. We have raised the year materially to reflect the strength of our position and have raised the second-half of the year right at the start of the year, right? And so I would not say that we are being cautious about the year. We feel really strongly about the performance.

I think as I noted with regard to what gives us confidence, it is the fact that all of our product lines, all of our customer segments by size, all of the types of commercial vehicles we use, multi-year agreements, storage as a service, traditional CapEx transactions, as well as the performance through all of our routes to market have outperformed materially. And the outlook for the year is very strong. So we feel really good about our position, both in terms of alignment to customer spend, the overall customer discussions we're having and the expanding opportunities we see across all types of customers.

Operator

Krish Sankar, TD Cowen.

Krish Sankar - *Cowen and Company LLC - Analyst*

Yeah, hi, thanks for taking my question and congrats on the good results. George, my first question is that you kind of closed like 350 AI and data lake deals this quarter. Last quarter is more like 500. I understand the deal sizes are getting bigger. Is there a way you can quantify how much of the deal size and revenue dollars in the July versus April quarter? And from a bigger picture perspective, how much of your revenues is driven by AI? And a quick follow-up for Vism after that.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

I think it's hard to quantify specifically what percentage of the revenue is driven by AI for two reasons. One is there are customer-specific -- AI-specific environments, right, which is what the 350 deals that we said count towards. Specifically GPU-connected AI stack-connected deals.

That being said, as we and others have noted, AI is now driving a broad-based modernization and re-platforming of the data infrastructure stack so that you can support the needs of high-performance inferencing use cases, the ability to build cross-application. Kind of data infrastructures, and that is reflected across the strength of our business.

So 350 were AI stack specific use cases, but the overall performance of the business reflects the influence of AI to modernize the entire data infrastructure. And we had signaled many years ago that we had started to see that momentum acceleration. We saw that in Q4. We are off to a super start in Q1. Our outlook for the year is very positive, and we see really good momentum across our entire portfolio.

Krish Sankar - *Cowen and Company LLC - Analyst*

Got it. Thanks a lot for that, George. And then just a quick question, your component costs are going up, so is your inventory levels. I'm just wondering, when you look at your products, you kind of spoke over the product gross margin.

What is the equation you're solving for, is it managing product mix? Or price capture to generate more gross profit dollars? And where are most of the inventory dollars spent on? Thank you very much.

Kris Newton - *NetApp Inc - Vice President, Investor Relations*

Yeah, so Krish, we did exit Q1 with a slightly higher inventory, but that's because obviously we continue to manage our supply and secure the supply to be able to secure product for the demand growth that we're seeing.

What we're basically focused on is the total gross profit for the company. We manage the total gross margin, but also the total gross profit dollars. And as you can see, as the top-line grows, we're seeing gross profit dollars growing almost a similar pace. That's because this is what drives really the earnings power of the business.

I think this is best demonstrated when you also sort of take it down to the operating margin line. And you can see how basically anytime we upsided gross profit and gross margin, we tend to generate quite a bit of operating margin leverage. So I don't know if this answers your question.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

I think one of the things we have also. One of the things we've also worked on to provide customers with the right solution for their use cases. I think we have started to see again the resurgence of hybrid flash in our portfolio, and we anticipate a much stronger contribution from hybrid flash. So we're, as Nhusang said, we are trying to solve as many customer problems with the right mix of portfolio.

Amit Daryanani - *Evercore Inc. - Equity Analyst*

Manage the overall business for gross profit dollar growth.

Krish Sankar - *Cowen and Company LLC - Analyst*

Thank you very much. Very helpful. Thank you.

Operator

Asiya Merchant, Citigroup.

Asiya Merchant - *Citigroup - Analyst*

Good afternoon. Hey, it's Mike Kidiz for Asia Merchant at Citi. So my first question is regarding pricing. So as pricing actions begin to flow through and materialize in the quarters, how much of the expected pricing benefit do you think has been realized? And are you seeing any change in demand elasticity, albeit early on?

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

I think I'll take the demand question and Bisam can address the pricing capture. I think with regard to demand, listen, we have always believed and continue to believe that customers budget in dollars. What we are seeing reflected in the market is that the overall budget priority for data infrastructure and storage has gone up significantly in our customers.

Within customers, for example, there are use cases where even at a higher price, they will be prioritizing spending on that, but within the same customer, they may defer till a future quarter a less priority use case, and we have seen that in our customer base. In some of those customers, they have also decided to go from a. Flash-based solution to a hybrid flash-based solution for the lower value use case, right?

And so I would say that the most important thing that we have seen is unlike in prior cycles with the significant increase in pricing, we are actually seeing broad-based infrastructure spending and we believe that it is correlated with AI and the modernization requirements of AI.

Kris Newton - *NetApp Inc - Vice President, Investor Relations*

And with respect to the delay between the pricing actions and when we start seeing it, look, we've taken actions to be more agile in this environment, so the impact of price increases should materialize sooner than in the past. In the past, for instance, it would take probably two to three quarters to start seeing it, but now we're seeing it much earlier.

Operator

Eric Woodring, Morgan Stanley.

Erik Woodring - *Morgan Stanley & Co Ltd - Analyst*

Super. Thank you guys for taking my questions. And George, I just want to maybe press you as a follow-up to Amit's question earlier, which is, I realize we're just one quarter into the year, it's early, but your second-half revenue is usually up like high single-digits versus your first half, and you're guiding it down. And so I understand the desire to remain conservative. And provide a guide that you can hit.

But given your qualitative commentary about demand, why couldn't you beat those expectations by 10%, 20%? I just want to make sure we're not missing anything just as we think about seasonality from the first half to the second-half and anything that could be maybe an offset to the way that we're thinking about normal seasonality. And then quick follow-up, please.

Kris Newton - *NetApp Inc - Vice President, Investor Relations*

So, Eric, this is Rhysan. When we think of the seasonality, if you adjust for the extra week in Q1, we're now roughly seeing, looking at 50/50, maybe a little bit when we're talking rounding here, a little bit more than 50 in the second-half, a little bit less than 50 in the first half. I mean, you can do the math, but that's just basically based on our visibility at this time. We do, however, see.

As George mentioned in his prepared remarks, really strong structural improvements in the demand. It's broad-based, it's driven by AI workloads, it's driven by modernization, and we basically are looking at that being the driver of revenue for the rest of the year.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

We have one quarter in today. We feel really good now, isn't it? We've raised Q2 guidance. We've raised the full year guide. We'll tell you more as we play through the year. We are super confident about our position in the market, and we'll tell you more as we play through the year.

Erik Woodring - *Morgan Stanley & Co Ltd - Analyst*

Awesome. Thank you, George. I can hear it in your voice, so I appreciate that, guys. And then, Wassam, just one clarification point. The comments that you make about product gross margins and your ability to maybe get a little bit better capture here in the first-quarter, is that purely a function of pricing and pricing confidence and kind of confidence in the demand, any elasticity response there?

I just want to make sure that when we think about your ability to maybe capture slightly. Better product gross margins. It's because it's a function of price and not necessarily the other side, obviously being the bomb inflation. Thank you.

Kris Newton - *NetApp Inc - Vice President, Investor Relations*

Look, I mean my comment is based on everything we see. As we look at as we form our outlook and we look and we project the business, we put everything that we know in our numbers and that's really what my comment is about. It has to do with pricing, it has to do with mix, it has to do with multiple factors that basically go and of course the cost side of the equation that basically goes into forming the funnel basically product margin.

Operator

Param Singh, Oppenheimer & Co.

Param Singh - *Oppenheimer & Co Inc - Analyst*

Yeah. Thank you for taking my questions. So you've done a couple of acquisitions, niche acquisitions recently and wanted to understand where do you see gaps in your technology portfolio today and where does it make sense to buy versus build? And then I had a follow-up.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

I think we are disciplined in our approach to acquisition. The two that we have talked about are tied to cloud and AI, and they provide us with differentiated offerings to accelerate our position in each of those use cases. With regard to Data Pelago, it is really about. AI-driven analytics and inferencing where we can accelerate the application processing adjacent to storage, providing customers a better inferencing solution top to bottom.

With regard to Jetstream, which we have acquired at the start of Q2, it really strengthens our already strong position in VMware migrations to the cloud. We have really good solutions for customers that want to use NetApp to migrate, but for customers that are non-NetApp on-prem, we have a really good starting point with a Dr. In the cloud solution. So those are the two areas, AI and cloud that we're focused on, and we feel good about the technology portfolio that we have, and we are doing tough-ins to enhance the overall solution value to customers.

Param Singh - *Oppenheimer & Co Inc - Analyst*

Understood, George. And then as my follow-up, your guidance applies that OpEx would go up as a percentage of revenue from the QQ level in the back half. So I want to understand why there is an increase in investment in the back half, and then where would that actually go? Was it R&D or sales and marketing? So if you could give some color on the investments that you're thinking about for the rest of the year, that'd be great.

Kris Newton - *NetApp Inc - Vice President, Investor Relations*

Yes, Faram, this is Risam. So the increase is driven really by a couple of areas. One, as we outperform, we're getting we have slightly higher variable compensation accruals. And then the second is really continuing to invest in our AI solutions. But when you look at the overall OpEx for the year and you sort of look what is implied in the guidance.

Year-over-year is still year-over-year increase for the full year, it still shows basically that the increase is much less than the half of the projected revenue growth. So we continue to be very disciplined in how we invest and how we look at our OpEx. That's, of course, because operating leverage and driving operating margin is a key element for our business model. Thank you so much for the color. Appreciate it.

Operator

Wamzi Mohan, BA.

Wamsi Mohan - *Bofa Merrill Lynch Asset Holdings Inc - Analyst*

Yes, thank you. I have a couple of clarifying questions. I think as you sort of think about the full year, A, would you say that. Your expectation of hybrid versus all-flash is similar versus your prior expectations? Or would you say that given what you're seeing with supply, that the upside that you're guiding to would be more driven by one versus other? And I have a quick follow-up too.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

Listen, I think that. If you look at the overall business, All Flash performed exceptionally strongly in Q1, right? It was up 47% year on year. So when we look at the overall year, All Flash still blows out our prior expectations. Hybrid Flash, when we had planned the year, we were cautious about customers.

Spending on non-mission critical workloads, that is typically what they do, right? When you see price increases, customers pull back on capital equipment spending. We are seeing broad-based acceleration in capital spending across the board, which is a sign of the AI supercycle. But then we are also seeing customers buying more hybrid flash. I would say if you look at the relative. Comparison, listen, all flash is super strong and will still be the predominant part of the acceleration in our business.

Wamsi Mohan - *Bofa Merrill Lynch Asset Holdings Inc - Analyst*

And as my follow-up, just is there any way you could give us some sense of this magnitude of these accelerated purchases, going back to Eric's question on half over half seasonality, you guys obviously sound very confident on the outlook over here, but could you just help us through think through. Mathematically, how large was the accelerated purchases or the contribution there, which we should factor in as pull forward or is that just acceleration of demand that is coming not necessarily from the second-half?

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

I think, first of all, we're not going to break it out, right, Wamzi? I think what I would tell you is the number of customers and the percentage of our customer base.

That have the financial flexibility to do accelerated spending is very small, right? These are very large private companies usually. Not even public sector organizations have the flexibility to do accelerated purchasing. So it is a much smaller percentage of customers than you would imagine, right? Very small percentage. What we saw in the results in Q1.

Was certain transactions that we expected to be built out over multiple quarters happening within a quarter. That doesn't mean that those same customers didn't defer other projects to accommodate these projects, right? And so I would tell you that it's a percentage of our business, we did not see it in Q4. But we saw it in Q1 and we felt like it was appropriate for us to acknowledge it. But it is not a material part of the overall business.

In certain clients, as we talked about, they are kitting out multiple data centers. They wanted to kit out -- they said, Let's do two of the four that we want to do faster this calendar year and we'll come back for the other two. We had expected. Kind of a more gradual build out of those. That is not common and widespread across the customer base.

Wamsi Mohan - *Bofa Merrill Lynch Asset Holdings Inc - Analyst*

Thanks, George.

Operator

Stephen Fox, Fox Advisors.

Steven Fox - *Fox Advisors LLC - Analyst*

Hi, good afternoon. I was curious if you could talk a little bit more about new customer wins. You mentioned that that also contributed to growth this quarter. I was curious from the standpoint of what maybe you're leading with and whether it's what kind of products, et cetera, and whether you're having success in certain verticals that we should be aware of. Thanks.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

Thank you for your question. We saw strength, as we said in our prepared remarks, in new customer acquisitions, in new workload expansion within existing customers, and stronger-than-expected tech refresh in our business. With new customers, we typically attack from two different vectors. Ones are kind of cloud-based solutions.

Or our purpose-built block optimized solutions for the corporate and mid-market customers and with our unified sort of simplify your infrastructure, unify it on one platform solution for the enterprise. And we feel really good about our position with both new customer counts, new customer dollars, as well as expansion within existing customers who are all as well ahead of our internal forecasts.

Amit Daryanani - *Evercore Inc. - Equity Analyst*

Thanks very much.

Operator

Katherine Murphy, Goldman Sachs.

Katherine Murphy - *The Goldman Sachs Group, Inc. - Analyst*

Thank you for the question. In lines with the following question regarding new customer acquisition through new workloads and new product categories, can you talk more about the success you're seeing in the AFX platform? I know you highlighted a public sector win in the quarter, but anything to share just on the momentum there and how that may be contributing to outlook for the full year? Thank you very much.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

AFX is built for the very high end of the performance and scale environment, so the number of transactions are not as many, but the size of the transactions are material. We have really focused it on the AI GPU as a service category, and we're seeing good progress. We talked about NeoCloud, we talked about the government agency that's building a private AI cloud, and so good progress. It is being certified across a large number of customers, and we're excited to continue to make progress on the solution. Thank you.

Operator

Tim Long, Barclays.

Tim Long - *Barclays Services Corp - Equity Analyst*

Thank you. Yeah, maybe a follow-on. And then the second one, on the public cloud business, 19% growth the extra week is still very good growth rate. We've seen it kind of around that number for the last year and a half or so. So just curious.

Know is there anything in the pipeline or new solutions or customer bases or anything that could maybe accelerate that that number and then second on Keystone I did want to touch on that you talked about growth and strength there you know looking at the you know the professional services line and backing out an extra week it doesn't look like it grew that much and we're kind of seeing or hearing about more.

Purchases in that area instead of paying up for more expensive hardware-based solutions because of the NAND price increases. So just talk about what you're seeing with those as-a-service solutions. I'm surprised we're not seeing a little bit more acceleration in that. Thank you.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

I think with regard to the. The public cloud business, listen, it stayed in the high 10s as we have scaled the business, so I'm encouraged by the sustained momentum of the business. Obviously, the cloud storage business performs at a much higher level than that, and so we continue to see strength in the 1P or the first-party and marketplace storage services. With regard to the things that we're bringing out, please come to Insight. We have more AI solutions with the hyperscalers. We have more use cases combining data on-prem with.

Hyperscale clouds and we have brought block storage and lower cost price points in multiple clouds, including Google and Amazon. So really good progress across the portfolio in cloud. With regard to Keystone, without giving you a specific number, I will just say our Keystone business.

Roughly in the same ballpark as prior quarters and in the same ballpark as our overall flash business, which is a really strong number. So we're excited about the progress of the business. We are seeing more new customers that we are targeting with Keystone, and we are bringing more capabilities to that part of our portfolio.

Kris Newton - *NetApp Inc - Vice President, Investor Relations*

And Tim, just to add to what George said on Keystone, keep in mind, Keystone didn't really benefit much from the extra week. It benefited a very minimal amount.

Operator

[Victor Chu, Raymond James].

Unidentified Participant

Hi, guys. Thanks for taking the question. So inventory nearly doubled sequentially. Just kind of wondering, is that a function of trying to secure NAND and other components against expected demand and maybe how much of the inventory increases earmarked specific customer orders and backlog? And a follow-up there, does the inventory build-up kind of give you better visibility into the remaining year and into next year?

Kris Newton - *NetApp Inc - Vice President, Investor Relations*

Yeah, I didn't get the second part of the question, but on the first part of the question, most of the inventory was some strategic purchases and basically us managing inventory to be able to ship to our customers. So I wouldn't say in my mind, this is a positive. We're really making sure that we have the supply to continue to drive the growth in the business. I'm sorry, could you please repeat the second part of the question?

Unidentified Participant

Yeah, does the inventory build-up kind of give you better supply and cost visibility, I guess, throughout this year and into next year? Yeah, typically, pricing is going to be less of a function, I guess.

Kris Newton - *NetApp Inc - Vice President, Investor Relations*

You're correct, typically done.

Steven Fox - *Fox Advisors LLC - Analyst*

Okay, great. Thank you.

Operator

David Vogt, UBS.

Steven Fox - *Fox Advisors LLC - Analyst*

Great. Thanks for squeezing me in, guys. So I'm going to keep it brief, George. You've answered a lot of questions. But just a question on demand as we think about the next couple of quarters.

Is there any sort of seasonality that you saw in the most recent quarter, particularly as we go into subsequent quarters from industry verticals? I know if we go into the October quarter, obviously, there are customers that have different fiscal year ends. Did you see any sort of demand.

Maybe slightly different seasonal demand patterns in the quarter? Because I know, I think Wasam mentioned that there was a little bit of a pull in. I'm just trying to get a sense for how do we think about sort of the normal seasonality? Maybe this isn't normal, but how do we think about the seasonality of demand as we move through the back half of this year?

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

Listen, I think our Q2 outlook, if you adjust for the extra week in Q1, is roughly in line with typical seasonality. And as Wasam mentioned. Second-half and first half are within spitting distance of our typical seasonality, right?

I think we have a really broad book of business, David. And so the movement of any one customer is not going to affect the broad book of business. I think the one exception to that is. Typical US Public sector seasonality, right? And that you are quite aware of. So we feel really good about the momentum in the business. Listen, as we said, exceptional start to the year. We had strength across pretty much every part of our portfolio, across every customer type, on-prem and cloud, every geography. We've raised the full-year guide. We've raised Q2 guide. We feel really good about the momentum in the business, and we'll tell you more as we get through the year. So super excited.

Great. Thanks, George.

Kris Newton - *NetApp Inc - Vice President, Investor Relations*

Thank you, David. I'll pass it over to George for closing comments.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

Thanks, Chris. With broad-based momentum, we delivered an exceptional start to fiscal year '27. Exceeding our guidance on every metric, strengthening our conviction in the durability of demand and underpinning our confidence in our materially higher expectations for the year.

The NetApp platform addresses a wide range of customer requirements, helping to operationalize AI workflows and accelerating cloud journeys, driving new customer wins and deepening existing relationships. Our ongoing innovation continues to strengthen the value of the NetApp platform and at our upcoming Insight Conference, we'll showcase new solutions that unlock value for AI and in high-growth markets.

We're building a durable foundation for long-term success, delivering sustained value for our customers and shareholders.

Operator

This concludes today's call. Thank you for attending. You may now disconnect.

George Kurian - *NetApp Inc - Chief Executive Officer, Director*

Goodbye.