REFINITIV STREETEVENTS

EDITED TRANSCRIPT

NTAP.OQ - NetApp Inc at Wells Fargo TMT Summit

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OVERVIEW:

Company Summary

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CORPORATE PARTICIPANTS

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

CONFERENCE CALL PARTICIPANTS

Aaron Rakers *Wells Fargo Securities - Analyst*

PRESENTATION

Aaron Rakers - *Wells Fargo Securities - Analyst*

Why don't we go ahead and get started. I'm Aaron Rakers. I'm the IT hardware and semi analyst here at Wells Fargo. Pleased to host Kris Newton, VP of Investor Relations at NetApp.

First of all, Kris, thank you for joining us (inaudible) --

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

Thanks for having me.

Aaron Rakers - *Wells Fargo Securities - Analyst*

I think you've got forward-looking statements.

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

I do have my safe harbor to read. Today's discussion may include forward-looking statements regarding NetApp's future performance which are subject to risk and uncertainty. Actual results may differ materially from the statements made today for a variety of reasons described in our most recent 10-K and 10-Q filed with the SEC and available on our website at NetApp.com. We disclaim any obligation to update information, any forward-looking statement for any reason.

QUESTIONS AND ANSWERS

Aaron Rakers - *Wells Fargo Securities - Analyst*

Nailed it. Perfect. From memory. So Kris, thanks again for joining us. So may -- maybe I'll start, I've got a list of questions here, but I want to go back to you guys had a very good Analyst Day earlier this year talked about the growth algorithms, talked about mid to high single digit and maybe we could start there just like, unpacking as we look out into next year or longer term. What are the key kind of growth vectors? The underlying algorithms of getting that kind of growth in the NetApp store. Sure.

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

Sure. So that story was told with a fairly consistent macro and IT spending environment in mind. For NetApp, we see primary -- four primary growth drivers, two which are secular and two that are company specific. So the first that we talked about is the all-flash market, the midrange portion of the all-flash market seeing outsized growth driven by secular trend away from 10K RPM hard disk drives and hybrid flash arrays in favor of QLC

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technology. We're participating in gaining share in that part of the market, and we expect that we're in relatively early innings there and that transition should continue for some time.

The second is a NetApp specific driver, and that's our recent entry into the block-specific market. Most of you know that NetApp has always been a unified storage, appliance, servicing file, block and object from a single operating environment. We recognize that there's a portion of the block market that really demands just block workloads and is only willing to pay for that relatively low level of data and storage management requirements.

So we introduced our all SAN array about a year ago. And so we expect to see growth as we displace some of the legacy block installations with our more modern modular block products. Also, NetApp specific is our cloud business. We see really healthy growth in our first-party and marketplace cloud storage services. NetApp is natively integrated, marketed and sold by each of the three leading hyperscalers with our ONTAP software. That's been growing really well, and we expect continued growth there.

And then finally, another secular trend, which is the rise of GenAI. We think that's more of a second half of calendar '25 before you start to see real momentum, but we have a lot of customers who are preparing their data infrastructure for AI as well as some early adopters of GenAI technologies and traditional AI continues to be a strong and healthy business for us.

Aaron Rakers - *Wells Fargo Securities - Analyst*

So before we unpack those couple of things because I definitely kind of a lot of the questions I have is that, again, for those, on the webcast in the audience, like the -- from there, the revenue, the P&L drivers, the gross margin, the operating margins remind us again of, where we're at how those long term trends look like?

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

Sure. So the model we put out at our Investor Day, for the long term model that we cited in June was a mid to upper single digit revenue growth on average over the three year period '25 to '27. We're well on target to be within that range for '25, based on the guidance we've given. A double digit EPS growth on average over that same time period and similarly, well on target to achieve that for this year, free cash flow margin excess of 20% and OP margin greater than 30% as we -- in FY27. So I feel confident about those target models as we said on our Q2 call.

Aaron Rakers - *Wells Fargo Securities - Analyst*

And just to be clear, I mean that's mid to high single digit in each actual year, right? That's --

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

It's on average over the period we're on target to achieve that this year. So.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Okay. Perfect. Perfect. I got you. So the -- let's double click on some of those things. So I want to start with the all flash because that's obviously one of the more tops I think last quarter you reported, not too long ago, $3.8 billion of revenue annualized is 19% growth.

I think you're outgrowing the market in general (multiple speakers) Yeah, by about two hours. So the all flash opportunity that you see is it fair to assume that's accelerating? And how do I characterize that of, hey, this is opportunity to go in and upgrade NetApp installed base versus maybe net new winning customers.

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

So, I think it's definitely both an opportunity to upgrade our installed base, expand within existing customers and bring on net new logos within the all flash market I think there's three drivers that we see happening right now. The first is that secular transition in favor of QLC technology.

I'd remind everyone, the storage market has never been monolithic. There's always been a high end, that's high performance. That market is fairly mature today serviced by TLC based NAND. Then the mid-range which is going through a secular growth cycle.

And then we've entered into the block market with all flash products. So that'll also help drive our growth. So early innings on the QLC replacement cycle, I think that will continue. We see pretty good new customer adoption as well as refresh of our installed base. And about 43% of systems under active support contracts are all flash today.

That's moved pretty consistently just about a point a quarter. Both the denominator and numerator are both growing. So you don't see pretty substantial change there. We recently refreshed the hardware platforms of our high performance A series all flash products. So we expect that there'll be a nice product cycle there as existing customers look to get on the latest and greatest most performance system. And then the ASA really does give us a much easier entry into the block, the very large block market.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Yeah. Let's maybe kind of double click on that last point because I think at the Analyst Day there was a discussion around 20,000 customers the opportunity that you see in the block space. I think I asked the question at the end of the day, but the ability to go in, I personally think it's kind of underappreciated. NetApp is the ability to actually participate in a market that despite the established position, NetApp has in the market is very untapped in that block area. So may maybe you can unpack how probably early innings there. But how do you think about success in that opportunity?

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

So I don't think the number was quite 20,000. But I don't remember what the exact number was, I'm not going to give you a correction. But -- so we've serviced the block market for customers who are looking to consolidate storage onto a single infrastructure with our unified storage products. The -- so there's some block in -- being used in most NetApp systems.

However, most data centers, like a traditional data center tends to get divided into your unstructured data pool where NetApp has been the dominant leader for decades and your structured data workloads like high-performance databases where Dell EMC is the clear leader.

By offering a product that has the right feature set at the right price that goes squarely after the other side where NetApp isn't dominant, and that is the larger part of the overall storage market, I think we can really make some big share gains there.

It's helpful to us that Dell continues to struggle with their storage business. And so it makes picking off the legacy installed base of companies like Dell or HP, a little bit easier. But we also see good and successful competition against some of the newer entrants as well.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Right. And so what inning are we in terms of actually starting to see that show up?

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

So we introduced -- so the ASA product has a high-performance flash version that's based on the A-Series product and the capacity flash version based on the C-Series product. We introduced those in Q1 and Q2 of '24. It takes some time to get qualified in customers' data centers, there's some political challenges that need to be overcome.

So I would say we're very early, but the early results and the growth of the A-Series has been really encouraging. We see a lot of customers who are faced with increasing complexity driven by AI, driven by hybrid multi-cloud, looking to find further and further standardization and they can do that with NetApp.

Aaron Rakers - *Wells Fargo Securities - Analyst*

And I would assume one of the insertion points for you in this market would be is that a lot of these customers have NetApp in some form or fashion, just not in that dedicated block area.

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

It's actually been pretty evenly spread across net new customers who don't use NetApp at all and existing NetApp customers. Sometimes it can be easier to break into a new to NetApp customer because existing customers have kind of established, drawn the boundary lines within their data centers. And so it can be a little bit more difficult sometimes to convince them to break those traditional boundaries.

Aaron Rakers - *Wells Fargo Securities - Analyst*

So I would go back kind of to the top level. I mean, you grew 19% in all flash is there. When you look at the demand profile in front of us and you think about 43% of your install base, is it fair to think like you guys can grow that? Do you think that you can grow this business under the umbrella of five, mid to high single digits that this business should grow mid-teens?

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

So, we definitely think that it'll grow. It'll be one of the faster growers within the NetApp P&L lines. I think the market growth is somewhere around 9%, 10%. So doubling the pace of the market growth as we've done for the past four quarters probably is unrealistic. I mean, we're the number two player at some point that just becomes defying gravity.

So I would expect to see the growth rates low. But that wouldn't be a reflection of our shared, our continued share gains. I think we'll continue to gain share when new customers, it's just a reflection of the tougher comps.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Right. And that flash business, when I think about it, it's been consistent, right. That business has a higher structural margin profile, explain what it is?

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

So in our flash portfolio of products, our customers tend to use more of the software value that NetApp brings and that's enabled us to charge more for that software value. The shift of our business from primarily disk or hybrid to all-flash is what drove us to call for a re-rating of our normalized product gross margin. So historically, NetApp's product gross margin was in the low to mid-50s, some variances driven by mix or outside factors above or below that, but that's sort of the normal case.

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With the shift to all-flash, we see the new baseline range to be upper 50% to 60%. And we expect that we'll stay there with some fluctuation. If you look at last year and the start of this year, we were at above or at the high end of that range, driven by the fact that we had acquired a lot of low-cost NAND when NAND prices were really cheap. As NAND pricing normalizes, we expect to be more within the range.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Yeah. And you probably can imagine I was going to ask the next question like that procurement of NAND, the strategic purchases. It sounds like -- just remind me again, the messaging from the company is that you're in a good spot. Do you see a scenario where you'd have to kind of get active again on some strategic purchases to protect that margin or how are you thinking about that right now?

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

So our expectation for the NAND market, right. So we went from like 1.5 years ago to historic lows than historic highs. And we think the market will soften again a bit in the beginning of next calendar year. While it was going through those variances, we used our really strong balance sheet to acquire a lot of NAND. We bought a lot at the lows of the market.

We continued to buy while prices were moving up and we hold the majority of the anticipated demand for the remainder of the year in our inventory today at prices that are significantly lower than market because it's not always easy to exactly match the specific SSD SKUs what the customer demand will probably be in the market buying incrementally in Q3 and Q4 of this year, and there's probably a tail of SSDs of these prebuys that go into the first quarter of '26. We completed our last kind of strategic purchase in Q2. At this time, I don't expect that we would do any more big strategic purchases unless there was another big dislocation in the market.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Perfect. Perfect. Anything I'm not asking you about in terms of the all flash market that we should be thinking about as far as, maybe I've got another list of on where we're at AI and stuff and we'll get to that. But anything else on the product portfolio that, we should think about as kind of a catalyst on the growth side, on all-flash?

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

I mean just that we're participating in that secular market change, that we've opened up new TAM and that we have a favorable new product cycle across the portfolio. They're all things that we believe will enable us to continue to grow well ahead of the market and gain share.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Perfect. Shifting gears. I think one of the -- I think, maybe one of the underappreciated areas within the NetApp growth profile is we're getting at that point where maybe the headwind associated with some of the public cloud vertical is starting to abate. And we've got the first-party native services growing quite rapidly. Why would that not accelerate growth as we move forward Walk us through unpacking that cloud business and thinking about the growth drivers underneath that?

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

Absolutely. So we do expect it to accelerate growth. In Q2, our cloud revenue grew 9% year on year. We called for a double-digit growth in the back half. So in Q3 a year ago, we made kind of a strategic pivot on our cloud business.

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We knew that the unique first-party relationships we have with the leading cloud providers and similar offerings in marketplace sort of all those hyperscaler-led motion, sales motions are the biggest opportunity that we have.

And we need to focus all of our resources on executing that opportunity and everything else really becomes a bit of a distraction if it's not in service of executing that opportunity. So in Q3 a year ago, we end-of-life some services.

We demonetized some services and integrated their functionality into the core first-party marketplace storage offerings. And then we refocused a couple of others to be more complementary to what we're trying to do with the first-party marketplace storage business. That did create some headwinds and those headwinds really did mask the strong performance of first-party and marketplace.

In FY24, first-party marketplace were 48% of the total cloud business. We'll give you an update on what they are for FY25 at the end of the year. But we've been growing in the 30% to 40% year-on-year range each quarter, and the growth of those services is finally starting to show through that's -- what drove the 9%.

We still have our Cloud Insights, which is a storage, observability tool, Spot and CloudCheckr, which are compute optimization tools and Instaclustr, which is an open source database management tool that are part of the portfolio as well as some data services that sort of wrap around the core storage offerings.

We expect those to be slow steady parts of the business. So the total business won't exactly reflect the growth of first-party marketplace but more and more it should show through.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Is it fair to think that those businesses stabilizing is something we should think about in the back half of the fiscal year, like we get to a point where they stop declining, and we just think that it's more steady state?

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

I think there might be -- I mean, definitely the headwinds have continued to lessen each quarter and by the time we reach next fiscal year, absolutely, they should be much more normalized.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Yes. And to put some perspective on that, you mentioned it, but you grew 30% and 43% these last two quarters in that first-party services business. So to me, it seems like the setup looks pretty good growth-wise into next year.

On that mindset, though, the other kicker would be is that I think the flow-through effect on the P&L is pretty high, right? The gross margin in that business is -- should be -- the flow-through of margin is almost 100%, like the incremental cost of that, right?

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

Absolutely. We -- if you look over just the past four quarters, we've dramatically improved the public cloud segment gross margin in Q2, 72%, 73%. We've said we will exit the year within our range -- our target range of 75% to 80%. So you've got this really healthy, growing business with improving gross margins, which will amplify the gross profit dollars, which are really what drives the ultimate profitability of the company.

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Aaron Rakers - *Wells Fargo Securities - Analyst*

Yeah. Perfect. Keystone, unbilled RPO in excess of deferred revenue, how much is that growing? Because to me, that's a metric that's going to matter.

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

It's a good metric. So the unbilled RPO is predominantly Keystone. There's some cloud services in there. We just introduced that disclosure in Q1 of this year and we -- I don't have the data for last year. So I don't have a year-on-year growth rates. But next year, you'll be able to see them. It grew 11% sequentially. It's a good indicator for future Keystone revenue growth.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Would you say it's fair to think that 85%, 90% of that the keystone. Is that the right way to think about it or?

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

Maybe not that high, but a growing portion of it will continue Keystone, that is really some, there's some cloud services that are subscription services that go into that unbilled number until very recently, until Keystone really became meaningful to us. And unbilled RPO wasn't material. So we said this deferred revenue a close enough approximation, which is why we just introduce the disclosure.

Aaron Rakers - *Wells Fargo Securities - Analyst*

So, yeah, so that's an interesting point really just starting to show up and that becomes an important metric. May maybe I should have started here, maybe for the people like Keystone is what it's, the as a service offering and the push on that piece of the story.

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

So Keystone is our on-premises as a service offering. We would say, and I think NetApp uniquely can say this. For customers who want truly elastic IT, the cloud is the clear path to go to, right? That's where you're going to see the most elasticity and flexibility.

But not every company is ready to go to the cloud or wants to go to the cloud, but they still want that OpEx experience. So Keystone is our solution for that. But then we have a lot of customers who also like CapEx. So our goal is to make it as easy for customers to buy from us as possible. So we always say it's any data, so file block, object, anywhere on-prem or in the cloud, anyway you want to pay for it, right, CapEx, OpEx.

Aaron Rakers - *Wells Fargo Securities - Analyst*

What is the -- that business if it becomes -- as it becomes maybe more visible, what's the typical terms of those deals? How does that price?

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

The minimum term of the year, but we have customers that are looking at multiyear terms. They're typically a minimum and then charges above the minimum.

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Aaron Rakers - *Wells Fargo Securities - Analyst*

And it's based on capacity. Okay. That's great. So the next topic is AI opportunity. So last quarter, just recently you talked about having 100 AI specific customer wins. The question was brought up on a call like that was a pretty good jump, right? That was 100 versus 50.

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

The market, I would say, is like frothy right now. So I don't know that you should try and draw a straight line in terms of next quarter, there will be 150. But we do see a lot of companies like prepping their data for AI. And so a lot of those wins, half of those wins were related to kind of AI data (inaudible) data lake modernization, consolidation and then the other half were either traditional or GenAI projects.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Okay. What are you looking at to start to call this? Because you -- I think one good thing that you did at the Day was that you didn't jump on the bandwagon of AI is the next big growth factor for NetApp. It's like -- it's there, it's interesting, but it's more longer duration in nature. What -- how does the company look at that starts to show, hey, this is starting to take off?

Like what are you seeing in those customer engagements and what you think maybe would be the inflection?

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

Right. I mean pretty much every company has some number, dozens of AI projects happening. I think they're all looking for what the killer use case is. I know every CFO is demanding efficiencies from AI. But it's really unclear exactly how that all plays out today.

And so I think as AI software packs grow, that's one great leading indicator, we'll continue to talk with our customers and work directly with them. We have a go-to-market team that specializes in AI. And so they're very closely involved supporting our sales reps and our customers in their AI journeys.

And we have some bleeding-edge customers that have created the -- with one customer that is embarking on the second version of its own proprietary large language model. The first one is they've deployed in an AI center of excellence all based on NetApp storage technologies.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Okay. The relationships you have with the, and I'm jumping around here a little bit, the public cloud partnerships you have and it's going back to your public cloud business and the first party services. They're -- they've been now well established, right. They've been in the market for a while. Are there opportunities to deepen those relationships? How do you think about extending those opportunity sets going forward?

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

Yeah. Absolutely. So I think, one thing we're doing is we're broadening the set of use cases that we address in the public cloud. So taking performance up and downstream, making larger smaller volumes available, integrating with other tools in the cloud.

And, most notably a lot of the AI tools to enable a frictionless customer experience there. We've also had recent announcements with both Google and Amazon with their distributed cloud offering. So Amazon Outpost can now manage NetApp block instances. And Google selected NetApp as the storage foundation for Google distributed cloud. So creating bespoke private cloud for public sector and other regulated customers who can't use the public cloud. So always looking for opportunities to get our technology more deeply embedded with them.

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Aaron Rakers - *Wells Fargo Securities - Analyst*

Perfect. The final topic, I want to touch on with you. It's a -- the capital return, strategy M&A how is the company's thinking evolved around that, how much cash do you need, comfortably on the balance sheet? Just, anything that you want to share on capital return?

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

Yes. So our stated goal for this year is to return 100% of free cash flow to shareholders, similar to prior years. We have a dividend. And so that's sort of the first call on capital because those are permanent. And then the remainder goes to buybacks with the goal of taking share count down.

Last year, I think we took share count down by about 4%, this year because of the stock price appreciation, the same amount of spend gives us about a 1% share count reduction.

We have both cash available and flexibility in our credit rating to take on incremental debt if there are M&A opportunities that we want to go after. We tend more towards technology tuck-ins, things that can help accelerate our road map, but there are other things that come by, and we're always evaluating and looking at the landscape.

Aaron Rakers - *Wells Fargo Securities - Analyst*

And on the dividend side, just because I get this question every once in a while from longer term marine investors. It's like, do you have a state of dividend growth?

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

We don't have a specific growth, we increased the dividend by a penny or two recently after holding it steady for some time, I wouldn't expect big growth. We're definitely not trying to chase yield, especially in the higher interest rate environment. But we do have a number of shareholders who like that as a means of capital returns and it does create a nice space and guaranteed return for people.

Aaron Rakers - *Wells Fargo Securities - Analyst*

And I lied, I'm going to go back to one other quick topic. So we mentioned on the all flash side, the competitive landscape, you brought up, Dell, EMC brought up HPE, the legacy kind of footprints and the market shares that those companies have had. I mean, there's a handful of others that are legacy guys. How, how do you see like sure competitively in the market?

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

So I would say, if you look over the history of the network storage market since the late 90s, the full stack vendors have really struggled to maintain share, right at the turn of the century, IBM owned the market. We don't really talk about their storage anymore. HP has managed to maintain share through acquisitions. Dell hasn't been able to grow the EMC base since their acquisition.

And personally, I think the way you think about and invest behind storage is really different than servers, right. Servers are like a commodity software, it's commodity hardware. It's all about supply chain management, and the sales pretty fungible.

In storage, it's all about specialty software, monetized through commodity hardware and the sale tends to be much more consultative at the enterprise level. And so historically, you've seen full stack vendors attrit share in favor of the pure plays.

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So I think both NetApp and Pure Storage are well positioned for share gains at the expense of the full stack vendors. We believe that our software value proposition is significantly stronger than Pure. We have a hybrid cloud story that they can't tell that I think drives customer preference for NetApp ahead of them.

Aaron Rakers - *Wells Fargo Securities - Analyst*

And then we get the question competitively every once in a while and it's more around AI and I think it's a different vein of AI than what you deal in, but like the WEKAs, the DDNs. Is it different? They're just different?

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

I mean, we see them and we do compete with them. They kind of focus their efforts on the high-performance model training portion of the AI market. And we do play there and we've won against them, and I'm sure they can all fight a win against us just as easily. But we think the much bigger opportunity is on the enterprise AI side.

Aaron Rakers - *Wells Fargo Securities - Analyst*

So Kris, anything that I should have asked you that I didn't or any topics of discussions you've had with investors that you feel aren't maybe appreciated enough?

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

Well, I think you did a great job at covering all the ground with your questions. I just leave everyone with a reminder that we're innovating faster than we ever have in the company's history. We have a really strong and recently refreshed product portfolio. We've entered new markets. We have a unique and compelling value proposition and we're really confident in our ability to achieve our long-term goals.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Perfect. Kris. thank you so much. Appreciate it.

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

Thank you.

Aaron Rakers - *Wells Fargo Securities - Analyst*

Thank you.

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