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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, and welcome to the Seagate Technology Fiscal First Quarter 2021 Results Conference Call. My name is Jason, and I will be your coordinator for today. At this time, all participants are in a listen-only mode. Following the prepared remarks, there will be a question-and-answer session. As a reminder, this conference is being recorded for replay purposes.

At this time, I would like to turn the call over to Shanye Hudson, Senior Vice President, Investor Relations and Treasury. Please proceed, Shanye.

Shanye Hudson

Senior Vice President-Investor Relations & Treasury, Seagate Technology Plc

Thank you. Good afternoon, everyone, and welcome to today's call. Joining me are Dave Mosley, Seagate's Chief Executive Officer; and Gianluca Romano, our Chief Financial Officer. We've posted our earnings press release and detailed supplemental information for our September quarter on the Investors section of our website.

During today's call, we'll refer to GAAP and non-GAAP measures. Non-GAAP figures are reconciled to GAAP figures in the earnings press release posted on our website and Form 8-K that was filed with the SEC. 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.

As a reminder, this call contains forward-looking statements, including our December quarter financial outlook and expectations about our financial performance, market demand, industry growth trends, planned product introductions, ability to ramp production, future growth opportunities, possible effects of the economic conditions worldwide resulting from the COVID-19 pandemic and general market conditions. These statements are based on management's current views and assumptions and information available to us as of today and should not be relied upon as of any subsequent date. Actual results may vary materially from today's statements.

Information concerning our risks, uncertainties and other factors that could cause results to differ from these forward-looking statements are contained in our most recent Form 10-K and 10-Q filed with the SEC, our Form 8-K filed with the SEC today, and the supplemental information posted on the Investors section of our website. As always, following our prepared remarks, we'll open the call for questions.

With that, I'll turn it over to you, Dave.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

Thanks, Shanye. Welcome everyone, and thanks for joining us today. We began fiscal year 2021 executing well across several key objectives, keeping us on pace for our full-year revenue outlook. First, we delivered on our financial commitments, navigating challenging market conditions to achieve September quarter revenue of \$2.31 billion and non-GAAP EPS of \$0.93, both exceeding the midpoint of our guidance range.

Second, we advanced our innovative product and technology roadmaps, which position the company for future data growth opportunities, including the introduction of CORTX, an open-source, object-storage software; and

Lyve Rack, which offers a simple and cost-effective solution for enterprises to manage their massive volumes of data, and in turn, unlock data value.

And third, to demonstrate Seagate's long-term commitment of returning cash to our shareholders, the board approved a 3% increase to our quarterly dividend, and a \$3 billion increase to our existing share repurchase authorization. These actions exemplify our confidence in the business potential and future cash generation capabilities.

In my comments today, I will summarize a few highlights from the September quarter and share some perspectives on the current market environment. Then, I'll outline how we have been positioning Seagate to capture a significant opportunities created by longer term data trends.

The results for the quarter reflect good execution against the backdrop of continued macro disruptions that impacted several of our key end markets. These disruptions were most pronounced in the enterprise market, as the anticipated slowdown in enterprise IT spending impacted sales of our enterprise nearline and mission critical drives.

Many enterprises reacted to the pandemic by prioritizing funding to support their remote workforce and accelerating their digital transformation plans. Accordingly, nearline revenue in cloud was solid in the quarter, although below the record levels of June.

The adoption of cloud services and the rise of new virtual economy, digital, remote and intelligent is driving ongoing cloud data center investments. According to IDC, 2020 maybe the first year in which cloud infrastructure hardware spending surpasses traditional IT infrastructure hardware spending. However, they also project, enterprise IT spending will pick up in calendar 2021, which aligns well with our outlook for gradual recovery in the enterprise on-prem market.

Data center investments vary among cloud service provider and Internet content customers, depending on the respective end market demand outlooks, expansion plans and architectural needs. Responding to these trends, HDD storage investments depend upon mass capacity transition readiness and install base replacement timing.

Taking these factors into account, we currently expect the cloud data center demand to improve in the December quarter and throughout the fiscal year, which supports a more elongated cycle than we've seen in the last couple of years.

In other markets, recovery is already well underway. For example, we realized solid double-digit revenue growth for our consumer drives, reflecting both the return to seasonal patterns and strength of the Seagate's brand among prosumers and gamers.

And in the video and image applications or VIA markets, revenue doubled quarter-over-quarter, following a resurgence in on-prem security and smart video projects. Recall, these markets were heavily impacted in the first half of the calendar year by COVID-related restrictive measures that precluded installations from taking place.

Over the long-term, the use of AI and other data analytics continues to drive new VIA edge use cases that extend well beyond security, including smart cities, smart factories, healthcare and even frictionless retail, all of which generate massive amounts of data and the need for cost effective edge storage.

We now believe the September quarter marks the bottom of the COVID-related demand disruptions, and we expect a gradual recovery from this point forward. What's along with the existing secular trends we're exposed to underpin our outlook for flattish revenue in fiscal year 2021 and reinforce the relevance of mass capacity storage in both the cloud and at the edge.

Seagate is a leader in mass data and we continue to deliver innovative technologies and secure, cost-effective data solutions that address our customers' needs today and in the future. Building on the strong momentum of our 16-terabyte products, we are qualifying our 18-terabyte drives with multiple customers and progressing very well. We are aligning our volume production ramp to customers' timings and HDD capacity transition readiness.

We also remain on track to ship 20-terabyte HAMR drives starting in December, which is an important milestone, as we believe HAMR technology will be the industry's path to scaling areal density and increasing drive capacities. Seagate will be the first to ship this crucial technology with a path to deliver 50-terabyte HAMR drives forecast in 2026.

Higher capacity drives not only enable data centers to cost effectively store more data in the same footprint, but also to do so in an environmentally sustainable way. The power consumed by an 18-terabyte Seagate drive is actually lower than a 10-terabyte HDD on a per bit basis. That means by replacing one 10-terabyte drive with our latest 18-terabyte product, customers can securely store 80% more data and do so more efficiently. However, the challenges for mass data storage posed by data growth extend beyond capacity, cost and sustainability. Increasingly, businesses are challenged by data sprawl and data security, which impact their ability to harness the value of their data.

Last month, Seagate hosted its inaugural Datasphere event, during which customers, partners and other industry thought leaders joined our team to discuss strategies for attacking these data management challenges. If you haven't had the opportunity yet, you can still catch the videos on our website.

Seagate's Lyve platform leverages our deep knowledge of data storage and architectures to help enterprises address the complexity of securely managing data across a distributed enterprise. Lyve Mobile is a series of seamlessly integrated edge arrays and data shuttles, designed to cost effectively and securely move data between endpoints, edge and into core cloud environments.

CORTX is an open-source, object storage software with a growing community of developers. CORTX enables enterprises to easily and efficiently manage massive pools of storage resources across their distributed enterprise.

Finally, Lyve Rack is a simple and easy to deploy solution, preconfigured with CORTX software and up to 1.5 petabytes of storage in a 4U rack. Lyve Rack helps enterprises build their own mass capacity optimized private storage clouds with less cost and complexity than ever before. We see multiple use cases across a diverse range of edge-centric vertical markets that all have a common need for mass data management.

For example, Raytheon Technologies is using CORTX to develop large-scale secure storage clouds for their federal and commercial customers. And two of the world's top automakers are evaluating this platform to efficiently move data across their fleets of autonomous vehicles. While Lyve is still in its infancy, customer reception has been tremendously encouraging, which together with our outlook for mass capacity storage makes me excited by the future prospects for Seagate.

With that, I'll now turn the call over to Gianluca and have him walk through the September quarter results.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Plc

Thank you, Dave. We achieved what we set out to do in the September quarter, delivering financial results consistent with our expectation in face of a dynamic and challenging market environment.

Revenue was \$2.31 billion, above our guidance midpoint and down 8% sequentially. This performance reflected strong recovery in the video and image application, or VIA, market. The strength in the VIA market, along with healthy demand from cloud data center customers partially offset the anticipated weakness in the enterprise market, which impacted our nearline, mission-critical and systems sales.

Total hard drive capacity shipments were 114 exabytes in the September quarter, down about 2% sequentially. Mass capacity shipments were 87 exabytes compared with 91 exabytes in the prior quarter and 64 exabytes in the year ago period, representing strong year-over-year growth. Our outlook for the December quarter support calendar year 2020 exabytes shipment growth that is well ahead of the long-term demand CAGR of 35% to 40% forecasted for this market.

On the revenue basis, mass capacity storage represented 58% of September quarter revenue and 63% of hard disk drive revenue, no change from a percentage basis with the June quarter, and up from 47% and 51%, respectively, in the prior year period.

As anticipated, nearline revenue declined sequentially, but remained healthy and within its historical range centered around 70% of mass capacity sales. Nearline shipments were 64 exabytes, down from record levels in June, but up 36% year on year, reflecting broad market demand for our high capacity nearline drives. We estimate that about [ph] 15% (12:42) of nearline capacity shipment are to replace existing drives, which equates to about 10 exabytes in the September quarter. We consider this a reliable revenue stream, but it should grow over time along with the installed base.

Average capacity per nearline drive increased 8% sequentially to 11.6 terabytes, supported by sales of our highly successful 16-terabyte drives, which have been the company's highest revenue product for three consecutive quarters and the highest nearline product for four consecutive quarters. We continue to ship our 18-terabyte drives and make positive progress on qualification plans at multiple cloud customers with volume ramp aligned with their timing.

Revenue for VIA increased sharply in the September quarter, as new security and smart video installation resumed following the COVID related pause we described in the first half of the calendar year. We anticipate healthy VIA sales over the near term and view this application as a long-term growth driver for mass capacity storage, particularly as new use cases for smart camera systems and analytical software emerge. IDC forecast revenue from video security camera is growing at a compound rate of nearly 13% through 2025, which is a strong indication of increasing storage needs at the edge.

The legacy market represented 34% of total September quarter revenue, the same percentage as a prior quarter and down from 46% in the year ago period. Increased sales for consumer drives partially offset the decline in the enterprise mission-critical market and sub-seasonal demand for PCs. Exabyte shipments into this market increased 5% sequentially to 28 exabyte, supported by the uptick in the consumer product, which [ph] have average (14:49) capacity of 2.7 terabyte per consumer drive.

We currently expect consumer demand to remain stable in the December quarter, with some improvement in the mission-critical market, consistent with a gradual enterprise recovery that Dave described.

Our non-hard disk drive business made up the remaining 8% of September quarter revenue, flat on a percentage basis with the prior quarter. Non-HDD revenue is still below our pre-COVID levels.

Sales of our SSD products trended lower due to challenging pricing environment, while we saw a slight improvement in the system business. I'll point out that many of our system customers are small to midsize enterprises, which are still being impacted by the pandemic. Accordingly, we expect it will take a couple more quarters before demand fully recovers.

In the September quarter, non-GAAP gross profit was \$614 million, which includes \$25 million of COVID-related cost. We are taking steps to partially offset cost associated with air freight by using more ocean freight.

Our resulting non-GAAP gross margin was 26.5%, including a 110-basis points impact from these COVID-related cost as well as a less favorable product mix and underutilization of the factories.

Consistent with our expectation, non-GAAP operating expenses came in at \$320 million, reflecting ongoing benefits of working from home, along with saving from our previously announced restructuring activities.

Looking ahead, we now expect operating expense to normalize at approximately \$330 million within the next one to two quarters, as we continue to assess market position and investment. Our resulting non-GAAP operating income was \$294 million and non-GAAP operating margin was close to 13% of revenue, which is the low end of our long-term target range.

Based on a share count of approximately 259 million shares, non-GAAP EPS for the September quarter was \$0.93. Capital expenditures were slightly lower in the September quarter at \$111 million, which represented around 5% of revenue. Based on the investment made over the past several quarters, we believe the industry has sufficient capacity in place to address near-term market demand growth. As a result, we are focusing our investment to support technology transition, rather than further capacity expansion.

We have been successful in transitioning more of our shipments to ocean freight, which, as I mentioned earlier, decreased the COVID-related impact cost on gross profit. We have also built strategy inventory for some critical components to protect against potential future supply chain risk. As a result, inventory increased sequentially to \$1.3 billion, which was in line with our plan. We expect inventory level to decline as we consume these components over the next few quarters.

We generated about \$186 million of free cash flow in the September quarter, which includes the one-time impact of restructuring costs. While these levels are still relatively healthy, we expect free cash flow to return to historical levels over the next few quarters, supported by our focus on operational efficiency and an improving demand environment.

In the September quarter, we utilized \$68 million to retire approximately 1.5 million ordinary shares, exiting the quarter with 258 million shares outstanding. We also used \$167 million to fund our dividend. As Dave mentioned earlier, the board approved a 3% increase to our quarterly dividend, raising the quarterly payout to \$0.67 per share.

The board also approved an increase to our share repurchase authorization of \$3 billion, which brings the total amount available to \$4.2 billion. The share repurchase authorization has no specific expiration date. Timing of execution on our authorization is dependent on several factors, including our financial position, available cash,

distributable reserve and capital requirements. These actions illustrates the confidence in our business strategy and long-term cash generation abilities.

We held cash and cash equivalents relatively stable at \$1.7 billion. As we approach the end of calendar year 2020, we are encouraged by emerging signs of recovery in the larger enterprise market and improvement in VIA demand. We expect solid cloud data center demand to continue in the December quarter, supportive of our view for a more elongated cycle. While we are still facing headwinds from COVID-related costs, we expect this will gradually decrease over the next couple of quarters.

Taking all these factors into account, our outlook for the December quarter is as follow. Revenue is expected to be \$2.55 billion, plus or minus \$200 million, up 10% sequentially at the midpoint. Non-GAAP operating margin is expected to improve sequentially and be in the lower half of our target range of 13% to 16% of revenue. And non-GAAP EPS is expected to be \$1.10, plus or minus \$0.15, an increase of 18% sequentially at the midpoint.

In closing, Seagate has continued to execute well during this period of prolonged uncertainty. We are navigating the current market and executing a strategy to capture the significant opportunities associated with a secular demand growth for mass capacity storage, and the emerging need to manage massive volume of data from the endpoint to edge to cloud core.

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

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

Thanks, Gianluca. As we conclude the first quarter of fiscal year 2021, we are encouraged by the recovery trends we're seeing in key end markets, but still expect macro uncertainty to persist near-term. We have demonstrated the ability to manage through challenges in the past. And with our team's strong execution and resilient financial model, I remain confident that we will emerge stronger from this current situation. Our improving December quarter outlook suggests we're on track to do it again.

I'm proud of our pace of innovation and how we are attacking the critical customer needs posed by data growth, data sprawl and data security. We're delivering on our technology roadmap and developing cost effective solutions that address the secular demand growth for mass capacity storage and data management.

I am confident in our business outlook for fiscal year 2021 due in part to the tremendous momentum we have built with our highly successful HDD business. And I believe our new initiatives, including our Lyve platform, position us for even greater opportunities in the future.

As a result, I'm more excited than ever about Seagate's growth opportunities, ability to generate cash and enhance shareholder value over the long term. Our performance would not be possible without the tremendous efforts of our employees and the ongoing support of our customers, partners and shareholders. Thanks to all of you.

With that Gianluca and I are happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Karl Ackerman from Cowen. Your line is open.

Karl Ackerman

Analyst, Cowen and Company

Q

Hey. Thank you for taking my question. Perhaps, Gianluca, you spoke during your prepared comments about shipping 20-terabyte HAMR drives for revenue this quarter. First, could you quantify the number of design wins you won to-date for HAMR? And second, your earlier comments seem to suggest you won't materially ramp 20-terabyte HAMR, perhaps because it's cost prohibitive on a dollar per terabyte basis versus your existing CMR offerings. I guess, is it possible to achieve 35% to 40% exabyte growth for calendar 2021 if the plan is to leapfrog to 24-terabyte HAMR drives? And how do we think about the margin mix associated with that? Thank you.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Hi, Karl. Like you said, it's a new platform out there in the world. And so, we're going to introduce it this quarter and we'll be watching the customers that we are qualified with, which is pretty competitive – highly competitive. So we don't talk about that. But we'll watch the performance and dial that knob accordingly.

I would say that until – to your point, until we get to 24 terabyte, there's not really a compelling transition. And so, we have to keep continue working that drive and we'll work that over the course of the next calendar year.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Plc

A

Yeah, I would say that it's important for us is the technology milestone that we are achieving in the current quarter with the first shipment of HAMR, it's not so important right now how many units we ship. The important is that the technology is working. And we are doing exactly what we said, and start shipping 20-terabyte HAMR before the end of the calendar year 2020.

Karl Ackerman

Analyst, Cowen and Company

Q

Very clear. Thank you.

Operator: Your next question comes from the line out of Katy Huberty from Morgan Stanley. Your line is open.

Kathryn Lynn Huberty

Analyst, Morgan Stanley & Co. LLC

Q

Thank you. Good afternoon. Dave, given the higher than average margins in the markets that are recovering enterprise and video markets, why wouldn't gross margins improve materially in the second half of your fiscal year?

And then just a follow-up for Gianluca, how do we reconcile the modest share repurchases in September relative to the new \$3 billion share repurchase authorization? Why not be more aggressive buying back the stock, given the signs of recovery you see in the business?

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. Thanks, Katy. I'll take the gross profit, gross margin points first. We do still have some COVID overhang, and then, obviously, last quarter, the factories were relatively empty compared to what we can do from a demand perspective. So, we're pivoting some of the capacity over from some of the legacy markets that are still challenged and into the mass capacity, exactly to your point.

So, over the course of many quarters, we will see that recovery in gross margins, so if that helps you think about it. I'm very confident of the product portfolio that we have. It's just a matter of re-equilibrating all the supply – the demand against our existing supply.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Plc

A

Yeah. And maybe before answering to the capital allocation and share buyback, we said that last quarter, and even the quarter before, that calendar 2020 was going to be impacted by the additional cost of COVID in term of gross margin and operating margin. So, we think that when the COVID situation will improve, our gross margin, because of our mix and because of the reduction of the COVID cost, will start to improve. So, we expect some improvement in the second part of the fiscal year.

In term of share buyback this quarter, as you know, we discussed that even during the last earnings release. During COVID, we want to be a little bit more conservative in term of cash preservation. But the board authorization is a – it is a more strategic long-term authorization; it's not something for the very short-term. We will think about how to use and how to maximize the impact of this new authorization. And with Dave, we will decide in the next weeks and months.

Kathryn Lynn Huberty

Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

Operator: Your next question comes from the line of Aaron Rakers from Wells Fargo. Your line is open.

Aaron Rakers

Analyst, Wells Fargo Securities LLC

Q

Yeah. Thanks for taking the question. Back on maybe the gross margin, I know in the prepared remarks you had alluded to taking on some strategic supply inventory. I think there's been a little bit of questions out there around some of the component pricing dynamics that maybe you guys have been seeing, be it in spindle motors or also maybe on the substrate side.

So, can you help us understand exactly what you are seeing in the component supply chain, and whether or not you're seeing some inflationary pressure and how you're managing that? Thank you.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah, Aaron, thanks. Certainly, through COVID, where factories were so strained, there were people that needed help. And so, we were out aggressively addressing that to make sure we had continuity of supply. And that's the comments that we made in the prepared remarks about the strategic inventory buys that we've done just to make sure that we have the right inventory placement.

Relative to the management, I think that's – on the supply chain, I think that's really starting to equilibrate now, and I'm fairly happy with where we are. We've got our suppliers in line with our capacity planning, again, and they're not getting turned off because of some of the COVID-related stuff. And I think it's very manageable from here. That's the way I look at it.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Plc

A

Yeah. And you have seen from our guidance in the current quarter and how we guided the full fiscal year, we expect this quarter and the next couple of quarters to be strong quarters. So we don't want to be limited by one component or two components. So we have tried to build a little bit of a strategic inventory, but we will use in the next two or three quarters.

Aaron Rakers

Analyst, Wells Fargo Securities LLC

Q

Great. And just as a quick follow-up, can you just give us an update on how we think about the capital expenditure plan, whether or not you're going to have to increase some of the wafer capacity, or just any update on CapEx spending as we move forward?

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. Since mass capacity had such strong growth for many, many quarters, now, and probably many years to come as well, we'll be continuing to pivot more of our capital allocation against that. We'll watch the legacy markets very carefully. Some, like we mentioned consumer markets, we're still fairly strong; others may be reaching a new normal as they continue to ramp down. You know we're not investing in those, and so we can pivot the capacity, whether it's wafer capacity or media capacity or drive capacity or whatever. We can pivot that capacity over that.

And by the way, that goes against the supply comments – or the suppliers' comments that you made as well. We're making sure we work all the way upstream in our supply chain with the suppliers to do that, also.

What we said specifically in the script is that we believe the industry has enough capacity in aggregate for that. We make those pivots. We'll still be needing to invest in, what we call, technology transition capacity, so the ability to make the new 18-terabyte and the HAMR drives and things like that, but that's not adding capacity, if you will; that's just investments in the technology transitions.

Aaron Rakers

Analyst, Wells Fargo Securities LLC

Q

Perfect. Thank you.

Operator: Your next question comes from the line of Ananda Baruah from Loop Capital. Your line is open.

Ananda Baruah

Analyst, Loop Capital Markets LLC

Q

Hi, good afternoon, guys. Appreciate you guys taking the question. Yeah, two, if I could. I'll ask them at the same time. Dave, I believe last quarter, you talked about fiscal year 2021 nearline growth of – I believe it was at least 35% exabyte. Is that still the case? You're reaffirming the flattish revenue guides for the year.

And then, also, just on mass capacity, just I did some quick calculation. I don't know and I'd love some context on this. This is like kind of like a dirty calc, but the difference between overall mass capacity exabyte ships and nearline ships was the largest ever and – it ties to the largest ever and the largest delta for the December quarter. And you're talking about pretty substantive growth, anecdotally, I think coming quarters, and then you said kind of years. Any context around sort of what's going on with that market? Obviously, there is sort of supply chain stuff and calendar-related stuff. So there is congestion – pent up demand. But is that something that can – are we talking about potentially 35% sort of nearline exabyte growth, and then plus meaningful mass capacity growth sort of through fiscal year 2021? I just would love some context, because it clearly came back super strong.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. Thanks, Ananda. So, the first thing you're on was the 35% to 40%. We believe we're still on track to outstrip that this year. We've been talking about that, even as mass capacity was struggling earlier in this year because of surveillance market and so on, these VIA markets came back really strong. And that's the answer to your – the second part of your question. So that was definitely back in its normal traditional representation, maybe even a little bit greater, given all the disruption that's going, the VIA markets were quite strong last quarter. We can expect that to persist as well going out. And that's logical recover I would say. And it's some of the new applications that are coming there, whether it's smart city applications or hospital applications, things like that. So we see a fairly healthy demand profile for that segment of mass capacity throughout the remainder of the fiscal year as well. So that's why we have a lot of confidence in those mass capacity numbers being so high.

Ananda Baruah

Analyst, Loop Capital Markets LLC

Q

And so, is it just – and just a quick [indiscernible] (34:17) clarify, Dave. Thanks. So is it nearline growth sort of greater than 35% fiscal year, and then mass capacity will be – whatever it is, is coming back, but that's – I'm sorry, not mass capacity, video related, it's going to be something in addition to that so we could see much more significant mass capacity growth in addition to 35% to 40% nearline growth.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah, sorry. So I wouldn't say nearline right now because of the – remember the on-prem discussions that we had last quarter. And so on-prem is still recovering, but it's just not strong. So you have the 35% to 40% is mass capacity all in, yeah, to your point.

Ananda Baruah

Analyst, Loop Capital Markets LLC

Q

Got it, got it. Thanks.

Operator: Your next question comes from the line of Steven Fox from Fox Advisors. Your line is open.

Steven Fox

Analyst, Fox Advisors

Q

Thanks. Good afternoon. Just to follow on those questions real quick. Can you just sort of go into why you think we're at a bottom in terms of the enterprise on-premise spending that you talked about in the prepared remarks? And how strong that comes back, say, over the next few quarters to get to your full year outlook?

And then in a similar manner, can you talk about the video markets? Obviously, they came back strongly. Like what's – is it a different shape of business that you're doing now post-COVID versus pre-COVID? How would you compare sort of mix now versus then? Thanks.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. Thanks, Steve. So, on-prem, I think on a hindsight now, which is we have really good visibility, I would say what happened with the early COVID supply reactions by a lot of customers caused pull-ins, and then the demand reality came later than that when people couldn't get back on-prem. So that's the bull whipping, if you will, that caused a little bit too much inventory in the chains. We're still recovering from that, frankly.

I don't expect it to recover to the prior levels because some of those markets, some of those on-prem markets like mission-critical were actually in decline anyway. So we think they'll come back to maybe the prior declining run rate, if that helps you think about it. The nearline piece of the on-prem will actually come back because that's moving up in exabytes as well. And there's still a lot of value in nearline on-prem storage.

Relative to the VIA markets and how they recovered so strongly, I think when people could – generally speaking, when people could get back on-prem, they were looking for new applications, some of them may have been facial monitoring, but some of them may have been temperature monitoring and some – things like that. When you do those installs, those upgrades, if you will, you don't have to install – you don't have to upgrade your entire network. You're upgrading typically the box that's the brain in the back room and that has hard drives associated with it.

So that's why we think that that was so strong, very global as well, so – and all happened at the same time. And again, we expect these kind of smart building, smart city applications to be continuing to be a good investment theme such that, if I look back year-over-year, we'll definitely get back to where we were year-over-year. We did last quarter and we probably will going forward as well. The muted front-end of this calendar year is – we don't know perfectly about the back end of the year, but we think that the VIA markets will be significantly stronger than that muted demand.

Steven Fox

Analyst, Fox Advisors

Q

Great. That's very helpful. Thank you.

Operator: Your next question comes from the line of Patrick Ho from Stifel. Your line is open.

Patrick J. Ho

Analyst, Stifel Financial Corp.

Q

Thank you very much. Dave, maybe just following up some of the comments you made earlier about capacity expansion and how you're transitioning to the nearline drive capacity demand that's out there. I know typically CapEx is – you're looking at a longer period of time on demand, where your products are going. As you begin transitioning to HAMR, one, how do you feel about the capacity in place as the 20-terabyte HAMR drives gets released? And then secondly, over the next two to three years, do you believe you'll need capacity expansion to meet the demand for HAMR over the next few generations?

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

A

Yeah. Thanks, Patrick. So a couple of things. We have quite a bit of capacity that is part of our install base. And we've been thinking for many years about those tools, those tools that we needed to make the HAMR transition. There are not too many incremental tools. So we feel like we can manage the transition quite well. We do need a little bit of, what we call, technology transition capacity to do that.

To the first part of your question, the bigger issue is really how we forecast what's going on in legacy markets and how much we pivot to mass capacity. So, we're going to be watching those legacy markets and what they'll do over the course of the next year, and it also started wafer, which is relatively long lead time. So we'll approach this judiciously.

I do think, over time, we will need more technology transition capacity as HAMR continues to ramp. So I think that's a fundamental limiter, if you will. And then, the market goes bigger, then we can react very quickly, I think, on CapEx, and especially with back-end test capacity or media capacity to react if the market goes big.

Patrick J. Ho*Analyst, Stifel Financial Corp.*

Q

Great. Thank you.

Operator: Your next question comes from the line of Kevin Cassidy from Rosenblatt Securities. Your line is open.

Kevin Edward Cassidy*Analyst, Rosenblatt Securities*

Q

Thank you for taking my question. On the video and image market that's coming back strong, can you say, geographically, which area of the country – world is it coming in?

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

A

Yeah. Kevin, I would say the areas that – almost everything was suppressed and almost everything's coming back. The distribution channel came back quite nicely in Asia, Southeast Asia and India, and a little bit less so in Europe just last quarter based on timing, but we are seeing it come back everywhere. And I think it was a fairly healthy quarter for us widespread geographically.

Kevin Edward Cassidy*Analyst, Rosenblatt Securities*

Q

Okay, great. And going forward, you're expecting it to continue to grow. Can you give an estimate of how much of a capacity it is or how much of your exabytes?

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Plc

A

Well, we talked about the mass capacity volume and we also informed the state about the nearline. I would say the difference between the two is mainly video and image application.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. There's a little bit of mass in the non-nearline, if you will, but we said – so I think 70% is nearline on the call. So you think about that as a 30 percentage – it's the bulk of that 30%, although NAS is a nice contributor as well and growing in exabytes.

Kevin Edward Cassidy

Analyst, Rosenblatt Securities

Q

Okay, great. Thank you.

Operator: Your next question comes from the line of Sidney Ho from Deutsche Bank. Your line is open.

Sidney Ho

Analyst, Deutsche Bank Securities, Inc.

Q

Great. Thanks for taking my question. Maybe two questions. First question is related to Huawei. Just want to confirm that can you talk about whether you are continuing to ship to Huawei and what is included in your December quarter guidance. It looks like your competitor may have stopped shipping maybe back in the middle of September. And do you think you're seeing some benefits of that in your December quarter?

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Well, I would say, Sidney, we don't talk about individual customers. I think if I go back 5 or 6 quarters now, we've been talking about how demand has been fairly disrupted, in particular, in China. And there's a lot of reasons for pulling in or pushing out demand, different projects that people are doing, financial planning they might be doing. We really focus on the end market demand. And that's how we construct our guide. I do think that relative to some of the products that we're talking about, there's fairly healthy demand – healthy supply inventory in the chain, if you will, and that gets to the mission critical question and whatnot.

We're a global tech company. We have a broad network of suppliers and customers. We continually monitor and remain in compliance with all the rules and regulations around. I think relative to some of the legacy markets, I think we're just watching too much inventory out there. So I don't think it's material, but it's all factored into our guide about what's going on in the end markets.

And then, our long-term view is that mass capacity storage will find multiple routes to market and that's what's growing and that's the way we're positioning ourselves.

Sidney Ho

Analyst, Deutsche Bank Securities, Inc.

Q

Okay. And maybe switching gears to talk about the nearline side. Dave, you talked about the timing of 18-terabyte drives. It will really depend on the customers' ramp. Do you have any insight as to when you will see maybe a unit crossover with 16 terabytes? And maybe, going forward, when I start thinking about beyond 18 terabytes, do you

think – do you expect the market to do from 18 terabyte next year going straight to the 24-terabyte HAMR? Or do you think there's someone between, say, the 20-terabyte – a period where 20-terabyte is picking up and how do you address that opportunity?

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

A

It's interesting. Our 16-terabyte is a very, very strong platform for us. So the unit crossover, we don't really think about it as units. It's actually such a similar bag of parts, as we've talked about before, that it's really a transition slightly in head capacity from our wafer fabs and some – a little bit of media turns and a couple other piece parts. So it's not a hard transition for us to make.

We've been saying for multiple quarters now, we really like our 18-terabyte, it's good quality drive, it's sailing through the qualifications the right – at the right level. So it's really about aligning with what the customers need from a volume perspective. And I don't think it's going to cross over in the next couple of quarters. We can drive it harder if we want to, but there's no real reason to do that, especially against the demand certainty that I think everybody needs.

To the other point, I do think that ultimately 18 terabytes becomes a big volume, I don't think people will wait for 20 terabytes. Although if an individual customer wants to do that, we'll go there with them. We're not going to talk about what our plans are there competitively, but I think there will be 20 terabytes in the market. I don't think everyone will wait from 16 terabytes to 24 terabytes though. I think you know the TCO proposition about re-qualifying an 18 terabytes or a 20-terabytes or something like that is significant, and I think people will do that.

So we're in deep conversations with all of our customers about this. These qual cycles take a long time. So we're locked and loaded with them on all this stuff and making sure we get them what they need at high volume.

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

A

Yeah. I would say for this calendar year, 16 terabytes is for sure the leading product in high capacity. And we expect in calendar 2021 to transition more and more to 18-terabyte. And then, as you know, we are developing the first generation and the second generation of HAMR that will take a little bit longer time to transition, but we think we have a very strong roadmap.

Sidney Ho*Analyst, Deutsche Bank Securities, Inc.*

Q

Okay. Thanks, Dave. Thanks, Gianluca.

Operator: Your next question comes from the line of Mark Miller from The Benchmark Corporation. Your line is open.

Mark Miller*Analyst, The Benchmark Co. LLC*

Q

Thank you for the question. I'm just wondering, what's your outlook for gaming in terms of sales in the gaming application, solid state memory has been showing up more and more. And what's your feelings about that?

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

A

Yeah. Thanks, Mark. So gaming has been very strong as part of our consumer business. For the last two quarters, now, I think that's part of the work from home, learn from home and play from home, too. The interesting thing that's happening there is that not just the PC space where some of the interesting titles are getting – the maps are getting bigger and bigger, but also the refreshes that are coming in the consoles, which we're tremendously excited about, we've been talking to those customers for quite some time about. It says that the consoles are going to get bigger, faster, more powerful; the experience is going to be awesome. We're very supportive of that.

I think when it comes to porting information from the old generation to the new generation, we think that we have a tremendously relevant role to play there. And then, helping the architecture of a lot better performance and a lot higher capacity, we have a lot to offer there as well. So we're super excited and always have been.

Admittedly, I've heard people talk about this segment before and not really know where it's going. And so, maybe [ph] they've (47:53) come to the wrong conclusions. That's starting to become a little bit more obvious as people are going through these transitions, but we're super excited about gaming, obviously. And I think it's a representative of what's going to happen to the edge over the next five years. Data has to get bigger, faster to be able to satisfy all the applications, and we believe this is kind of one of the lead dogs on that hunt. And so, we're very active in participating in it.

Mark Miller*Analyst, The Benchmark Co. LLC*

Q

You talked a little about the inventory. Inventories were up, but you say they're going to be coming down. Could you give us a little more color about what's going on with inventories, in your [ph] belief (48:29)?

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

A

Yeah. Like we said, we've said in the prepared remarks that we've done some strategic – at a time when the market was relatively low, we wanted to make sure we didn't get into any situations where we had any losses in our factories because we couldn't get parts. And with a lot of suppliers – I think we need to appreciate that a lot of suppliers and sub-suppliers were having issues in their supply chain because of COVID and things like that. We didn't want to get into any of that. So we pulled a little extra inventory and we'll bleed that out over the next couple of quarters, re-equilibrate.

Mark Miller*Analyst, The Benchmark Co. LLC*

Q

Thank you.

Operator: Your next question comes from the line of Jim Suva from Citigroup Investment. Your line is open.

Jim Suva*Analyst, Citigroup Investment Research*

Q

Thank you very much. As many of the questions were asked and you gave great details on, I'll pivot and ask one more about the stock buyback. It's kind of interesting to note the timing of it when you still had over \$1 billion, if

my math is right, about \$1.2 billion left. And I believe in your prepared comments, you mentioned you'll kind of do it opportunistically or kind of as you go.

So I'm just kind of thinking about – that comment about why announce a big \$3 billion in addition to the \$1.2 billion you have left, or are you meaning to imply you're going to put the capital to use a little bit sooner? Because of the current cadence you have, it would still be well over a year to exhaust the \$1.2 billion that you have. So, I'm just kind of triangulating about the timing and what you meant, and the size of it, which is very impressive.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah, just referencing our past authorizations, our last one was in October of 2018. By the way, it phases up with our October board meeting, so that's part of our process to address these things, so dividends as well. But our last one was \$2.3 billion of new authorization in October of 2018. The previous one before that was April of 2015. I think we – to your point, we had \$1.2 billion left. We wanted a little bit more flexibility to that. So we look at it over the long-term and make those decisions.

Jim Suva

Analyst, Citigroup Investment Research

Q

Okay. Thank you very much.

Operator: Your next question comes from the line of Mitch Steves from RBC Capital Markets. Your line is open.

Mitch Steves

Analyst, RBC Capital Markets LLC

Q

Hey. Thanks for taking my question. I kind of wanted to turn back a little bit to the gross margin discussion there. It sounds like the higher end companies or customers are starting to purchase more products. So I guess, why isn't there going to be a year-over-year improvement in gross margin, particularly in calendar year 2021, assuming that some of these operational issues kind of fade away due to COVID and all that stuff that happened this year, plus a mix shift to the high-end? I guess, why aren't we seeing that kind of flow through more next year?

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Well, I think it will flow through more next year. I think we're just in the – to your point, we're in the – still in the throes of having factories that are underutilized and moving a lot of capacity from some of the legacy markets, which are under-represented, into mass capacity. We just can't do that that fast, so we've got some – a little bit of overhang of what we just been through. But I have confidence that we'll fill up the factories with the right product after that and be able to get solidly back into our margin range.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Plc

A

Yeah. When we talk about COVID costs and the impact, we just communicate the direct impact, right. There are a lot of other negative impacts that we have, for example, the under utilization that Dave is mentioning is not, for sure, including what we communicate as a COVID impact in total. So that's a small part of it.

So we think in the next two or three quarters, that will improve. And this is also, now, aligned to our CapEx discussion that we just had. So we expect gross margin and operating margin, which is more important to us, to improve in the next two or three quarters, hopefully.

Mitch Steves*Analyst, RBC Capital Markets LLC*

Q

Okay. And then, just as a follow-up on that, just assuming that you're able to operate as usual, meaning that there's no distancing or anything like that at the factory, et cetera, can you maybe help us understand what type of margin bridge you would normally see? So what I'm trying to get at here is you probably found some operational savings just given the work-from-home environment and could probably make some reductions there or adjustments there. So how do we think about the, I guess, organic gross margin number, if we didn't have this kind of one-time impact?

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

A

Yeah. As far as organic gross margins, we'd be in our range, I think, based on the full utilization, if you will. You know we focus more on operating margin, and we've been tending towards the high end of our range. The reason we're at the low end of our range right now, really, is – to your point, it's the gross margin issue with the under absorption of the factories. But I think we'll continue to manage the operating margin range; try to get back to the high end of our range as quickly as we can. It'll happen as a function of the footprint that we need from an OpEx perspective, which we benefit from no travel and everything else, everybody else – everyone else is talking about, just spending control, but also the gross margin that you're asking about.

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

A

The last quarter before COVID impact, we were actually above our long-term range of 13% to 16% in terms of operating margin. So the mix today is even slightly better I would say in terms of profitability. So we expect to go back to that level and even higher than that when the pandemic impact will start to decline and go away.

Mitch Steves*Analyst, RBC Capital Markets LLC*

Q

Okay, perfect. Thank you so much.

Operator: Your next question comes from the line of Nic Heisler from SIG. Your line is open.

Mehdi Hosseini*Analyst, Susquehanna International Group*

Q

Yes. This is actually Mehdi Hosseini from SIG. I have one follow-up question and I want to go back to your mass capacity, excluding nearline. It did double on a Q-over-Q basis. Is that driven by surveillance, especially in the APAC region?

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

A

Yeah, Mehdi, it is. I mean, especially APAC, I'm not sure I'd say especially APAC because I think it's picking up around the world, but it was so underrepresented around the world, the quarter before, because, to our point, before nobody could get back on-prem, surveillance came back quite nicely. We reacted well to it. Some of that we were predicting and some of that we had to react to.

So there's recovery in every market. Some markets are recovering faster than our projection, some are not as fast as our projections, but we had such confidence, especially later in the quarter, that that's why we kind of were communicating that, and surveillance was a strong part of it.

Mehdi Hosseini

Analyst, Susquehanna International Group

Q

And I have a question on the object storage efforts. I could see why it would fit into your long-term strategy. But maybe you can help me better understand how you can avoid alienating your existing customers as you pursued this strategy, and essentially, to me, it seems like moving up the stack.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Yeah. I don't look at it as alienating simply because there really isn't an object store that's designed specifically for mass capacity. So many object stores – there are fantastic object stores that are out there. Some of them are very proprietary, others have come and gone, but a lot of them have been purposed for many other reasons, not just mass capacity. And so, we are the ones designing the drives. We are the ones designing this object store. We're opening up the community so other people can help us. And that we've been getting great response from the community. So thanks for pointing it out.

I look at it as a great opportunity for mass capacity storage, whether it's on-prem or in the cloud or something like that, and we want partnerships. And we think if that's tailored to all the features that we need for our drives, whether it's MACH.2 drives or HAMR drives or any other features that we want to go develop, I think this will be the fastest route to market, the fastest to the best TCO proposition for people using it. And we're open to any partnership with anyone. I don't think it's going to be a threat to anyone.

Mehdi Hosseini

Analyst, Susquehanna International Group

Q

Got it. Clear. Thank you.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

A

Thanks.

Operator: Your last question comes from the line of Nikolay Todorov from Longbow Research. Your line is open.

Nikolay Todorov

Analyst, Longbow Research LLC

Q

Yes. Thanks. Dave, I think in your last time that you guided to CapEx to grow as a percent of revenue. And I believe at the time the understanding was that your capacity mix between legacy and mass capacity was optimal. Now you're alluding that there's some underutilization because of excess legacy capacity. I guess, can you give

us some color on what inning are we in that transition? I mean I understand that this is a continuous dynamic, but when can investor expect for you to optimize that capacity mix?

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

A

Yeah, it's a good question. And what inning are we in? It's kind of hard to say because we're going to have to wait a little bit longer until we see the recovery out of COVID of all the representative markets, but it's exactly the way we're thinking about it what you describe. Before we could have said, these markets will transition according to some game plan, these legacy markets will go out in five years or four years or whatever we were expecting, there's been some changes to that because of COVID. We either have to know if we get back on that curve or maybe that curve is a permanent downshift and then we can transition the capacity. So we're making that investment. And I think the key point is that from our perspective in the industry, I think everybody's going to have to go through this relative to the footprint and we like our chances relative to that. We're just telling you that we'll probably be below our 6% to 8% range that we would have talked about in that Analyst Day because of the impacts of COVID.

Nikolay Todorov*Analyst, Longbow Research LLC*

Q

Okay. And related to that, I think you guided to mass capacity exabytes growing that 35% to 40% for fiscal year 2021. I guess are you willing to give us a number for total capacity for fiscal year 2021 growth, including legacy?

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

A

Yeah, we've never really done that before. I mean we've been very focused on the growth market of mass capacity. And now that's surpassed legacy significantly, I think that's the growth driver. The legacy markets, to be very frank, we're still studying them because, like I said, things like consumer, we're maybe ahead of where we thought they would be because of COVID and other markets maybe under represented as well.

Nikolay Todorov*Analyst, Longbow Research LLC*

Q

Okay, and if I can just squeeze one more? You mentioned different demand profile by cloud customers. Can you maybe talk about that in terms of geography, particularly interested in hearing your take on the China cloud demand and maybe where's the volume in terms of capacity with those customers?

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

A

It's a very complex questions, it's a very good question, something that we struggle with as well. There's many different types of applications. There's not just one kind of cloud service provider, one kind of application, one kind of drive, if you will. So from our perspective, the investments that the cloud customers are making depend upon all these different strategies they might have.

From our perspective, we have a great portfolio lineup. We can transition from products in our factory from one customer to another given enough lead time, and we have good relationships with all those customers. So, I do think that there's some things in the cloud depending on where you're geographically, where there are logistics challenges to grow. And we said this a little bit last quarter. You can't build data centers or can't get people on prem to build them. So there are priorities being made for service level agreements where people in the cloud may have real strain on them at the front end with compute or networking or something like that. And that may

push off some of the mass capacity install. We're working with customers on that, too. So we know the demand's coming. We just have to make sure we're tied with the customers about what they need exactly when.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Plc

A

June quarter was a record quarter for cloud. September was not at the same level, but was very healthy. And we expect December quarter to be still very strong.

Nikolay Todorov

Analyst, Longbow Research LLC

Q

Got it. Thank you.

Operator: There are no more questions. I'll turn the call back to management for closing remarks.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Plc

Thanks, Jason. Seagate continues to execute well through the current business environment. We're very encouraged by the improvements that we're seeing in some of the end markets and we expect gradual recovery throughout this fiscal year. Longer term, we see no change to the secular growth in mass capacity data. And we're very excited by the opportunities that we can foresee ahead.

I'd like to once again thank all of our customers, suppliers, business partners and our employees for their ongoing support of Seagate. Thanks, everyone, for joining us today.

Operator: Thank you, everyone, for joining today's call. That concludes the conference call and you may now disconnect.

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