

Seagate Technology

HAMR'ing ahead into F2Q24 earnings

Maintain Rating: BUY | PO: 87.00 USD | Price: 83.97 USD

HAMR ramp marking inflection in HDD market

On January 17th, Seagate (STX) announced the launch of its Mozaic 3+ platform, a new hard drive architecture that features a nanophotonic laser for writing data. CFO Romano previously noted that the company continues to expect to ship 1mn HAMR drives in C1H24 and shipments could increase from there. Early qualification is going well and the company expects to qualify HAMR at all the major Hyperscalers through 2024. Over time, the company expects to migrate the portfolio to HAMR, which will drive margin benefits (relative to competitors using CMR). Maintain Buy given an improving demand backdrop and expanding margins that will drive positive revisions.

HDD demand bottoming out; Cloud spending stabilizing

According to our Cloud Capex tracker, top CSPs in US and China are increasing capex spend of \$165bn in CY23. CY23 is a significant slowdown from the 17% y/y growth in CY22, CY24 is expected to reaccelerate to +21% y/y (\$197bn). Improving cloud capex should drive demand for storage and therefore HDDs which STX is positioned to benefit. STX has recently been negatively impacted as hyperscalers were digesting inventory of HDDs. However, we believe inventory is normalizing over the next few qtrs and the increased demand from AI workloads should drive demand for HDDs & HAMR drives.

Thoughts heading into Dec Qtr Earnings, March Guide

We model F2Q24 rev at \$1.6bn, inline with consensus and company guidance. We model Operating Margin (OM) at 5%, inline with company guidance and 10bps below consensus. Our estimate for OM is a sequential increase of 220bps but a y/y decline of ~80bps. STX guided for F2Q underutilization charges to remain flat q/q (\$59mn) but is now realizing the full benefit of the restructuring plan. The improved cost structure is a tailwind to margins despite the lingering underutilization charges. We model inline but see room to the upside in the March guide for Rev & Margins driven by increased volume, price, and lower depreciation expense.

PO stays at \$87; Estimates unchanged

Our PO stays at \$87 on 11x C25 EPS of \$7.80; estimates unchanged. We choose C25 given the material cyclical improvement off the trough levels in 2023.

Estimates (Jun) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	8.19	0.19	0.68	5.85	9.66
GAAP EPS	7.37	(2.55)	(0.58)	4.91	8.56
EPS Change (YoY)	45.2%	-97.7%	257.9%	760.3%	65.1%
Consensus EPS (Bloomberg)			0.29	4.34	6.33
DPS	2.76	2.80	2.80	2.80	2.80
Valuation (Jun)					
P/E	10.3x	441.9x	123.5x	14.4x	8.7x
GAAP P/E	11.4x	NM	NM	17.1x	9.8x
Dividend Yield	3.3%	3.3%	3.3%	3.3%	3.3%
EV / EBITDA*	8.6x	24.2x	29.7x	12.5x	8.6x
Free Cash Flow Yield*	7.3%	3.6%	3.1%	6.0%	9.2%

* For full definitions of *IQmethod*SM measures, see page 6.

19 January 2024

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Stock Data

Price	83.97 USD
Price Objective	87.00 USD
Date Established	6-Dec-2023
Investment Opinion	B-1-8
52-Week Range	54.32 USD - 87.93 USD
Mkt Val (mn) / Shares Out (mn)	17,565 USD / 209.2
Free Float	95.8%
Average Daily Value (mn)	179.27 USD
BofA Ticker / Exchange	STX / NAS
Bloomberg / Reuters	STX US / STX.OQ
ROE (2024E)	NA
Net Dbt to Eqty (Jun-2023A)	NA
ESGMeter TM	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

CSP: Cloud Service Providers

HDD: Hard Disk Drive

AI: Artificial Intelligence

CMR: Conventional Magnetic Recording

HAMR: Heat Assisted Magnetic Recording

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Timestamp: 19 January 2024 05:00AM EST

iQprofileSM Seagate Technology

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	32.2%	3.9%	8.9%	29.8%	37.7%
Return on Equity	495.3%	NM	NM	NM	NM
Operating Margin	16.9%	0.9%	-2.3%	10.5%	15.7%
Free Cash Flow	1,276	626	541	1,052	1,611

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	0.9x	23.9x	5.1x	1.0x	1.1x
Asset Replacement Ratio	0.8x	0.6x	0.7x	0.8x	2.5x
Tax Rate	2.4%	49.4%	16.6%	3.2%	3.8%
Net Debt-to-Equity Ratio	NM	NM	NM	NM	NM
Interest Cover	8.6x	1.3x	1.5x	4.8x	7.3x

Income Statement Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	11,661	7,384	6,607	8,602	10,802
% Change	9.2%	-36.7%	-10.5%	30.2%	25.6%
Gross Profit	3,469	1,351	975	2,075	2,886
% Change	18.9%	-61.1%	-27.8%	112.7%	39.1%
EBITDA	2,593	926	753	1,796	2,607
% Change	27.0%	-64.3%	-18.7%	138.4%	45.2%
Net Interest & Other Income	(263)	(334)	(333)	(317)	(310)
Net Income (Adjusted)	1,833	39	141	1,211	2,000
% Change	32.6%	-97.8%	258.3%	756.2%	65.1%

Free Cash Flow Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	1,833	40	140	1,212	2,001
Depreciation & Amortization	451	513	252	227	216
Change in Working Capital	(643)	1,162	495	(155)	(6)
Deferred Taxation Charge	(9)	10	28	0	0
Other Adjustments, Net	25	(783)	(201)	(60)	(60)
Capital Expenditure	(381)	(316)	(173)	(172)	(540)
Free Cash Flow	1,276	626	541	1,052	1,611
% Change	13.1%	-50.9%	-13.5%	94.4%	53.1%
Share / Issue Repurchase	(1,731)	(340)	35	0	0
Cost of Dividends Paid	(610)	(582)	(582)	(580)	(580)
Change in Debt	499	22	212	0	0

Balance Sheet Data (Jun)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	615	786	852	1,335	2,376
Trade Receivables	1,532	621	951	1,111	1,424
Other Current Assets	1,886	1,498	881	1,113	1,336
Property, Plant & Equipment	2,239	1,706	1,515	1,339	1,412
Other Non-Current Assets	2,672	2,945	3,021	3,141	3,392
Total Assets	8,944	7,556	7,220	8,040	9,940
Short-Term Debt	584	63	0	0	0
Other Current Liabilities	2,971	2,529	2,734	2,972	3,501
Long-Term Debt	5,062	5,388	5,666	5,666	5,666
Other Non-Current Liabilities	218	775	759	759	759
Total Liabilities	8,835	8,755	9,159	9,397	9,926
Total Equity	109	(1,199)	(1,939)	(1,357)	14
Total Equity & Liabilities	8,944	7,556	7,220	8,040	9,940

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

IT Hardware

Company Description

Seagate Technology (STX) designs, manufactures and markets hard disk drives for use in enterprise storage, servers, desktops, laptop computers, and other consumer electronic devices. It also has a growing solid state drive and storage systems portfolio. The company sells its products directly to OEMs, as well as distributors and retailers, and its production capabilities are vertically integrated.

Investment Rationale

We expect revenue and earnings to inflect higher as legacy market headwinds become smaller and mass capacity needs increase net of any cannibalization from Flash. We expect overall industry margins to improve and strong shareholder returns to continue. We rate STX Buy.

Stock Data

Average Daily Volume 2,134,935

Quarterly Earnings Estimates

	2023	2024
Q1	0.48A	-0.22A
Q2	0.16A	-0.08E
Q3	-0.28A	0.24E
Q4	-0.18A	0.74E

Thoughts heading into Dec Qtr Earnings

Seagate: We expect rev and EPS inline with guidance in Dec qtr

- For F2Q24 we model rev at \$1.6bn inline with consensus and company guidance.
- We model GM 21.3% vs consensus at 21.5% but upside can be driven by increased volume, increased prices, and reduced depreciation expense (\$9mn in F1Q24 & \$20mn incremental more in F2Q).
 - The change in depreciation could be as much as a 200bps tailwind to GM.
- We model F2Q24 OM inline with company guidance and 10bps below consensus at 5%.
- We model F2Q24 tax expense inline with guidance and consensus at \$15mn.
- We model F2Q24 EPS \$0.02 above guidance and \$0.01 above consensus at (\$0.08).
- We model share count at 210mn, inline with consensus and guidance.

Figure 1: STX Second Quarter Fiscal 2024 Results Preview

We model STX F2Q24 rev at \$1.6bn

December Quarter (Q2 FY24) Results

(\$ Millions Except Per Share Data)	BofA Est (Dec 23)	Consensus	Management Guide for FY Q2 24	Prior Q (Sep 23)	Q/Q Growth	Prior Y (Dec 22)	Y/Y Growth
Revenue	\$1,562	\$1,548	\$1.55bn +/- \$150mn	\$1,454	7.4%	\$1,887	-17.2%
Gross Margin	21.3%	21.5%		19.8%		21.4%	
Opex (pre-SBC)	254	256		248	2.6%	294	-13.5%
Operating Margin (pre-SBC)	5.0%	5.1%	Mid-single digit	2.8%		5.8%	
Interest/Other Exp	(80)	(83)		(93)	-14.0%	(82)	-2.5%
Tax Rate	-796%	-334%	Tax expense ~15mn	13.2%		-25.9%	
EPS, Non-GAAP (pre-SBC)	(\$0.08)	(\$0.09)	-\$0.10 +/- \$0.20	(0.22)	-63.6%	0.16	-149.0%
Diluted Shares	210	210	~210mn	208	1.0%	207	1.4%
Free Cash Flow	119	(11)		57	108.1%	172	-31.0%
Revenues of Segments:							
HDD revenue	1,403	1,383		1,295	8.3%	1,663	-15.6%
Systems/SSD/Other revenue	159	162		159	0.0%	224	-29.0%

Source: BofA Research, Visible Alpha, Company Data

BofA GLOBAL RESEARCH

- For F3Q24 we model rev at \$1.7bn, ~\$50mn above consensus.



- We see possible room to the upside in the guide driven by increased volume and prices
- We model GM at 23.9%, slightly higher than consensus at 23.2% but see room to the upside in the guide driven by the increased volume, increased prices, and lower (\$30mn per qtr) depreciation expense.
- We model F3Q24 OM at 8.3%, 1% above consensus.
 - Our higher operating margin estimate is driven by higher gross margin and revenue levels for the quarter.
- We model F2Q24 EPS \$0.24 above consensus at \$0.14.

Figure 2: STX Third Quarter Fiscal 2024 Results Preview

We model STX F3Q24 rev at \$1.7bn

March Quarter (Q3 FY24) Results

(\$ Millions Except Per Share Data)	BofA Est (Mar 24)	Consensus	Prior Q (Dec 23)	Q/Q Growth	Prior Y (Mar 23)	Y/Y Growth
Revenue	\$1,689	\$1,633	\$1,562	8.2%	\$1,860	-9.2%
Gross Margin	23.9%	23.2%	21.3%		18.7%	
Opex (pre-SBC)	263	261	254	3.5%	282	-6.6%
Operating Margin (pre-SBC)	8.3%	7.3%	5.0%		3.5%	
Interest/Other Exp	(80)	(84)	(80)	0.1%	(87)	-8.0%
Tax Rate	16.6%	29.1%	-795.7%		-163.6%	
EPS, Non-GAAP (pre-SBC)	\$0.24	\$0.14	(0.08)	-402.4%	(0.28)	-186.8%
Diluted Shares	207	210	210	-1.4%	207	0.0%
Free Cash Flow	186	7	119	56.5%	174	6.7%
Revenues of Segments:						
HDD revenue	1,526	1,455	1,403	8.7%	1,604	-4.9%
Systems/SSD/Other revenue	164	168	159	3.0%	256	-36.0%

Source: BofA Research, Visible Alpha, Company Data

BofA GLOBAL RESEARCH

Price objective basis & risk

Seagate Technology (STX)

Our PO of \$87 is based on 11x our C2025E EPS estimate of \$7.80. This multiple is towards the higher end of the historical P/E range of 7x-13x, and is warranted in our view as earnings momentum turns positive and peak earnings can be higher than historical peaks. Earnings are at a cyclically historic low and hence we look out to C25 for a more normalized earnings power of the company. The multiple balances near-term headwinds against the return of a more rational HDD industry and back to revenue and EPS growth.

Downside risks to our price objective are: (1) further unit declines in desktops and notebooks, (2) worse than expected industry pricing, (3) increased usage of NAND flash, (4) share loss to WDC in the enterprise HDD market, and (5) degradation of cash position and potential violation of credit facility covenants. Upside risks are: (1) significant pickup in high capacity/nearline HDDs, which could drive ASPs and gross margin higher, (2) improved technological advantage over NAND flash so as to reduce SSD penetration, (3) consumer PC refresh cycle, and (4) improved free cash flow generation.

Analyst Certification

I, Wamsi Mohan, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - IT Hardware and Technology Supply Chain Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Amphenol	APH	APH US	Wamsi Mohan
	Apple Inc.	AAPL	AAPL US	Wamsi Mohan
	Corning Inc.	GLW	GLW US	Wamsi Mohan
	Dell Technologies Inc.	DELL	DELL US	Wamsi Mohan
	Flex Ltd.	FLEX	FLEX US	Ruplu Bhattacharya
	HP Inc.	HPQ	HPQ US	Wamsi Mohan
	International Business Machines Corp.	IBM	IBM US	Wamsi Mohan
	Jabil Inc.	JBL	JBL US	Ruplu Bhattacharya
	Nutanix Inc	NTNX	NTNX US	Wamsi Mohan
	Roku, Inc.	ROKU	ROKU US	Ruplu Bhattacharya
	Seagate Technology	STX	STX US	Wamsi Mohan
	Sensata Technologies Holdings Plc	ST	ST US	Wamsi Mohan
	TD Synnex Corp	SNX	SNX US	Ruplu Bhattacharya
	TE Connectivity Ltd.	TEL	TEL US	Wamsi Mohan
	Teradata Corporation	TDC	TDC US	Wamsi Mohan
	Western Digital Corporation	WDC	WDC US	Wamsi Mohan
NEUTRAL				
	Arrow Electronics Inc.	ARW	ARW US	Ruplu Bhattacharya
	Avnet Inc.	AVT	AVT US	Ruplu Bhattacharya
	CDW Corp	CDW	CDW US	Ruplu Bhattacharya
	Concentrix Corporation	CNXC	CNXC US	Ruplu Bhattacharya
	Hewlett-Packard Enterprise	HPE	HPE US	Wamsi Mohan
	Pure Storage	PSTG	PSTG US	Wamsi Mohan
UNDERPERFORM				
	DigitalOcean	DOCN	DOCN US	Wamsi Mohan
	NetApp Inc.	NTAP	NTAP US	Wamsi Mohan
	Sanmina Corporation	SANM	SANM US	Ruplu Bhattacharya
	Vishay Intertechnology, Inc.	VSH	VSH US	Ruplu Bhattacharya
	Vizio	VZIO	VZIO US	Wamsi Mohan



iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} +$

Other LT Liabilities

Enterprise Value

Denominator

$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$

Sales

Basic EBIT + Depreciation + Amortization

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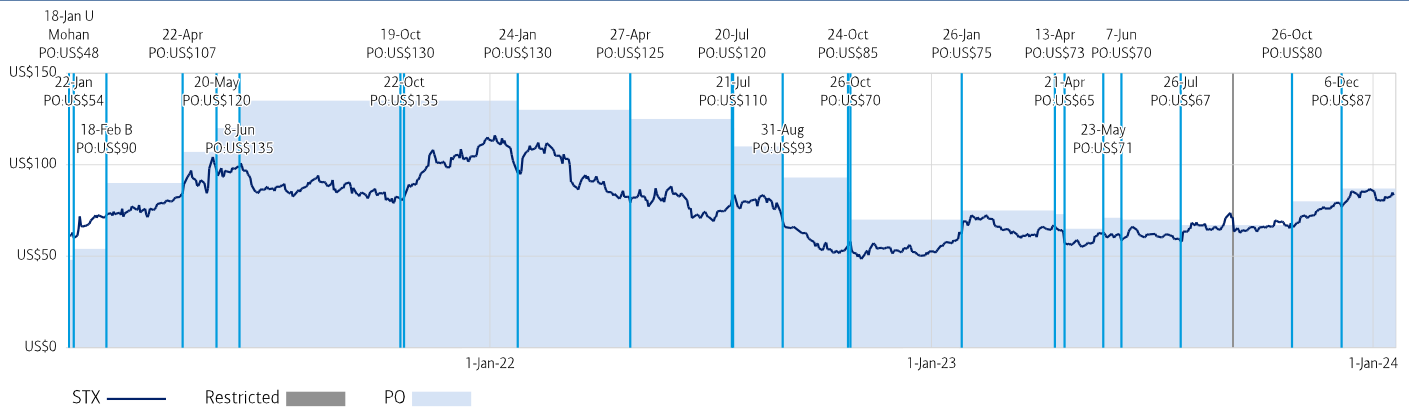
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Seagate (STX) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Technology Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	215	53.09%	Buy	111	51.63%
Hold	97	23.95%	Hold	45	46.39%
Sell	93	22.96%	Sell	24	25.81%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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