**Question-and-Answer Session**

**Operator**

Thank you. (Operator Instructions). Our first question comes from the line of Aaron Rakers with Stifel. Your line is open.

**Aaron Rakers - Stifel**

Yes. Thanks for taking the questions. First of all, can you talk a little bit more about the Xyratex business in the LSI or the flash business? By my calculations, it looks you've crossed through about $200 million of revenue if not $210 million of revenue from that other volume item. Can you just talk about the trajectory of that and when you would expect that to possibly be additive to the gross margin going forward?

**Steve Luczo**

Yes. Again, we mentioned last call; we’re not breaking out those. We will tell you, you're wrong, we didn't breakthrough 200, but the momentum in the business is good.

**Aaron Rakers - Stifel**

And as far as the gross margin on that piece, so you talked about that being a pressure point still to the gross margin. And when do you expect that to actually possibly swing to the positive?

**Steve Luczo**

During this fiscal year, we said that would sum up the pressure, but beyond that would be gross margin accretive. So, we expect in next year and beyond the gross margin accretive.

**Aaron Rakers - Stifel**

Okay. And the final question for me. Can you talk a little bit about the demand environment that you're seeing from a PC perspective? There is ongoing debate about inventory build. What you guys think about in terms of sell-through and that relative to the commentary going into the December quarter?

**Steve Luczo**

Well, this is same commentary that was going in, in the September quarter as I recall. Demand was pretty good in September through the quarter, [pull] so far in the December quarter are good; inventories are well within the balance we like to see. So, we currently don't see any stress on the system.

**Aaron Rakers - Stifel**

Okay. Thank you.

**Operator**

Our next question comes from the line of Joe Wittine with Longbow Research. Your line is open.

**Joe Wittine - Longbow Research**

Hi. Thanks. Steve, you mentioned strength hybrids any color or details you can provide. You said clients of the notebook, desktop or even client server and maybe more importantly what has kind of changed in the OEMs seemingly being more interested versus two, three quarters ago?

**Rocky Pimentel**

Yes. This is Rocky Pimentel. Certainly we were really excited to see the success of the hybrid this quarter across both the client and midrange product categories. I think our OEMs have really embraced the value proposition of the consumer. The product experience now is equal to from a feature set, the kind of experience you have on accelerated storage, but at a very attractive price and capacity value propositions. So the OEMs have building enthusiasm for the category as Steve said. We're very positive as we go forward. And as we said, we shipped over 12 million to-date and we had a very strong quarter which was over 3 million this last quarter. So, we continue to see strength in that overall program.

**Joe Wittine - Longbow Research**

Could you bucket it at all, Rocky as far as which categories, which product segments you’re seeing the biggest uptick?

**Rocky Pimentel**

Yes. I mean it is led by the client end, but like I said, the midrange desktop and even at the cloud class customer or products, as well as even the enterprise products we're seeing people interested in the hybrid solution. So, it's certainly been driven at the client, but it's continuing to move up the stack and we think long-term all categories will have value proposition which should get good customer traction.

**Joe Wittine - Longbow Research**

Okay. And quickly on enterprise, I think it was first understandably so choppy, what if anything can you tell us about the hybrid scale et cetera plans for calendar ‘15? Specifically do you see any risks for any kind of malaise after this current spending uptick like you saw throughout fiscal ‘14?

**Rocky Pimentel**

Yes. I think we’re cautiously optimistic. Obviously we saw some pretty interesting results over the last several weeks from major OEM, some of the cloud providers. But I think we see overall the category is still showing optimism like Steve said quarter-to-date we’re still seeing strength in that category. So, we continue to be cautiously optimistic. And the fact that we’re servicing customers across all the key geographies gives us a lot of confidence in the category.

**Steve Luczo**

I think just also the hybrid deployment in enterprises, to go a little further on Rocky’s point, where we really see initial traction there is in the cloud service providers especially as they to need the specific workloads. And I think as that continues to deploy, obviously that gives some competitive advantage. So, we expect continued traction there.

On the legacy side, it’s probably a longer design-in in terms of the various levels of software that have to be changed to accommodate some of the real performance improvements. So, I think it’s really the cloud service providers that are pulling that which is I think from our perspective pretty exciting given the shifts to technology there.

**Joe Wittine - Longbow Research**

Helpful, thanks.

**Operator**

Our next question comes from the line of Sherri Scribner with Deutsche Bank. Your line is open.

**Sherri Scribner - Deutsche Bank**

Hi. Thank you. Just wanted to get a little more detail if you could provide it in terms of your view about the different end markets as we go into December, the TAM is going to be down roughly 3 million. Is that down part going to be PCs and what is your view about enterprise and gaming in that mix? Thank you.

**Steve Luczo**

Well, I don’t know that it’s down because I don’t know that anybody has been able to total up what the TAM is for September quarter yet. So, we’re just facing it off of industry analysis which is what we've said we're going to start doing. So, a lot of analysts I have talked to thought that the September quarter was 142 to 145. So, I can't say that 145 is down for December. I think seasonally, we would expect a bit of a slowdown on the gaming side, because there is a little bit of front loading for the December quarter that impacts the component companies in the September quarter. It also leads to little more linearity in October, which is nice from a production perspective. But in general, we would expect obviously gaming to be down a little bit that might be offset by retail being up a little bit and again, we seem to seeing so far cloud strength is pretty good.

And I think in the client space, it's I think we're kind of finding new territory here as the shift between desktop and notebook continues to evolve. We saw really great growth in the desktop in the first half of the year and the growth has slowed down a little bit in the second half and of course notebook has taken off. So, we feel pretty good about the client side. And as you know long-term, we think it's really positive market opportunity that people haven't focused on yet. I mean if the cloud does have the things that it’s supposed to, what it means for the client is actually pretty spectacular, the view that this client goes away is kind of a traditional net zero some gain theory of technology which I think has been pretty disproven over the last 25 years.

So, we think as the ecosystem grows, the end points are going to be pretty dynamic as well.

**Sherri Scribner - Deutsche Bank**

Thank you.

**Operator**

Our next question comes from the line of Amit Daryanani with RBC Capital Markets. Your line is open.

**Amit Daryanani - RBC Capital Markets**

Thanks a lot. Good morning guys. Two questions from me; one, I guess on OpEx to start with. I guess organically if I look at it [$525] million taking of the extra week that you had in September, so is the guide of 555, that incremental $30 million call it, is that essentially all driven by the LSI assets getting rolled in or other factors being considered as well?

**Rocky Pimentel**

That’s driven with the full quarter of LSI asset, number one; offset coming down the 14th week, we don’t have, but we also have our annual increments next quarter. So, all that sort of washes out to be somewhat about flat quarter, slightly up. And Steve talked about we’ll continue to invest these new adjacencies which will keep us to that high-end of the 13% to 15% for the year. We’ll manage that very closely, but a lot of opportunities there. So, we’re not going to shy on those investments that yield good returns in the future.

**Amit Daryanani - RBC Capital Markets**

Fair enough. And then if I could just ask question on the cloud service provider market, the hyper scale side. It has been fairly lumpy for you guys in fiscal ‘14. But I’m curious as you keep expanding that customer base beyond the two, three customers we talk about, I think you talked about Baidu this time. As you keep expanding your customer-base, as you potentially interact more with them, is there a potential this becomes less volatile for you and more predictable in fiscal ‘15?

**Steve Luczo**

Yes, I think absolutely. I think clearly for the next say two to three years, the 10 or 15 largest CSPs are still going to drive a lot of that variability quarter-to-quarter. On the lumpiness, if we think about in the last year, has been there, but if you think about it over the last three years, it’s pretty much been up into the rights phenomenon; and I still think it’s just a issue of when they get big efficiency gains either in terms of time to deployment or utilization rates, it’s still against the backdrop of demand for storage that’s accelerating against the larger and larger principal and growing probably at a faster rate. So I think even there while you may lumpiness associated with some advancements in technology, the big ones are still driving a lot of storage. And then to your point, over the next three or four years, you're going to have another maybe 2,000 or 3,000 service providers that are solving different needs which will certainly take the lumpiness out of it overall. And then throw on top of that five to seven year period of time where you're going to have Fortune 4000 deploying some version of “hybrid cloud” which should take even more lumpiness out.

So again clearly, it's a diversified customer base for the drive industry relative to where we were for the last 30 years. And the long-term trend we believe is certainly less lumpiness and less concentration on the customer set.

**Amit Daryanani - RBC Capital Markets**

Thank you.

**Operator**

Our next question comes from the line of Monika Garg with Pacific Crest. Your line is open.

**Monika Garg - Pacific Crest**

Hi. Thanks for taking my question. First question is on the cloud segment. I remember on the analyst event you guys talked about 650 million to 700 million in revenue from cloud solution group. If you could talk about how that is tracking and how to think about the gross margin from that segment?

**Jamie Lerner**

Hey Monika, this is Jamie. We are tracking to that goal and probably beyond that. This quarter, we were over 109% of plan; we grew 11% quarter-over-quarter, seeing strength across the three big businesses that we run; EVault was up 18% year-over-year, ClusterStor and [Strata store], the high performance computing segment was up 18% year-over-year and the majority of our revenues in our OEM, our OneStor business which was up 21% quarter-over-quarter. So the business continues to grow quickly. I think the customers are excited, the partners are excited. So right now, we feel comfortable about hitting that plan this year and we see continued growth in that business for at least, say at least to eight quarters I can say continuous growth from at this point.

**Monika Garg - Pacific Crest**

Thank you. Then the last one just a follow-up on the hybrid side, you’re getting good growth in that segment. Can you talk about is it mainly a client hybrid drive which you are seeing the strength in the market because I think you see kind of enterprise hybrid drive picks up too?

**Rocky Pimentel**

This is Rocky Pimentel. As we mentioned it, the majority of the strength this quarter was at the client level, but we see growing momentum in all the categories of the product lines.

**Monika Garg - Pacific Crest**

Thank you. That’s all for me.

**Operator**

Our next question comes from the line of Rich Kugele with Needham & Company. Your line is open.

**Rich Kugele - Needham & Company**

Thank you. Good morning. A couple of questions, first on the hybrid side again. I believe your controllers are from the Samsung Seagate joint partnership on what you’re shipping today. And if so, will you be able to migrate that overtime to the -- although the five controller or will you continue to remain on the Samsung side?

**Dave Mosley**

Hi Rich, this is Dave. The controllers for the hard drive business are developed in-house, they’re not merchant controllers. We believe merchant controllers across the number of different SPP and PCI solutions that we have, but the ones that we use on the hybrid drives all the different markets that Rocky talked about this service are developed in-house.

**Rich Kugele - Needham & Company**

So, the roadmap just emerged now?

**Dave Mosley**

Well, I think we’ll continue to do that in-house development. We may use some external technology depending on what the best control point is for the flash that we have to use. But right now I think we feel pretty comfortable with what we have in-house to be able to keep going on the hybrid drives for quite some time.

**Steve Luczo**

The key to the hybrid anyhow, Rich, at that level is far more anyhow. It's the algorithms that we have that maximize the usage of a flash.

**Rich Kugele - Needham & Company**

Okay, great. And then on the cloud side, obviously your overall average capacity was up nicely, but are the cloud buyers mainly still on 4 terabyte or has they shifted to the 6 terabyte? And then within that range, can you talk about Baidu and that relationship and whether that can be applied to other accounts or you see this as bit of a one-off?

**Steve Luczo**

We're not going to talk about specific customers other than the press release is that we've done with their permission. In terms of capacity points, they are shifting to 6 terabyte.

**Rich Kugele - Needham & Company**

Okay. Great, thank you.

**Operator**

Our next question comes from the line of Katy Huberty with Morgan Stanley. Your line is open.

**Katy Huberty - Morgan Stanley**

Thanks. Good morning. How does the later Chinese New Year influence the pace of demand in late December early January versus the last couple of years, and then I have a follow-up?

**Dave Mosley**

Katy, this is Dave. We don't have too much concern about where Chinese New Year is falling relative to the back half of Q2 and then getting Q3 started. I think traditionally if you go back a couple of years we had some hypotheses that we would have a very fast January and then would slowdown after Chinese New Year. But I think given the strength that we're seeing is geographically right now, some of that maybe muted this year.

**Katy Huberty - Morgan Stanley**

Okay, got it. And then Pat, I think you guided for gross margin up slightly in December. Can you just walk through the gives and takes on gross margin next quarter? And then can we get back up to that 28.5% range that you are running out in fiscal?

**Pat O'Malley**

Yes. I think 28.5 is sort of a sweet spot in the short run and that’s what we’re trying to move that model too on a very short run even December quarter. And that’s primary as Steve talked about, there was a lot of, if you want to call it low-end business or with the gaming generally has -- it's good cash flow business, but lower gross margin. The market mix will help drive us to that next quarter. And as Rocky talked about some of the migration to a higher capacity in the cloud, we see that going. So, we have some capacity and product mix driving it.

So, those two items are probably fuelled offset by challenges we’ve talked about of integrating the rest of business, but we feel comfortable with those challenges that we could offset them. So, I think in the 28.5 is sort of sweet spot in the short run where we want to get to.

**Katy Huberty - Morgan Stanley**

Great, thank you.

**Operator**

Our next question comes from the line of Keith Bachman with BMO Capital Markets. Your line is now open.

**Keith Bachman - BMO Capital Markets**

Hi. I had two as well. Pat, just going back to the gross margin, your capacity per drive was up quite a bit and your gross margins were down sequentially. I know you mentioned the gaming probably aid up a little bit, but was there price competition also at the high-end as cloud service providers? In other words, which was the bigger impact on the gross margin change for the September quarter?

**Pat O’Malley**

Pricing was relatively in line with what we thought, so wasn’t a concern on that, Keith. Obviously areas where we have strong portfolio, we’ll use that and sometimes drives a little more pricing, but you get back on your volume at last just -- curve. So, we’re comfortable with the trade-offs of pricing, so we didn’t really see it as much there. Much more saw it in the market mix as a compression this quarter. And so, I think that’s placing our benefit next quarter.

**Keith Bachman - BMO Capital Markets**

Okay. Then my follow-up is on the cash cycle. Days sales outstanding was up a little bit, so your cash conversion cycle was in that 25 day range. So, it's consistent over the last couple of quarters. Is that where you anticipate being over the next couple of quarters in that 25, 26 day range or can that come back down a little bit to maybe the low 20s?

**Pat O'Malley**

Yes. We're targeting that for ‘20. I think I get two days of DSO for -- a lot of OEM this quarter which we generally are, but the timing of that collection was a little up, but we expect to get maybe pick up two days of DSO and we could pick up a day or two off of the DIO.

So, we know where the model is off a little bit, but we think we're -- it pushed it to 25. We're very comfortable with that. That was driving overall good business that lined up for a good delivery of Q1 which is a good cash flow model for Q2. So, I think 20 would be where we push the model to; we could to be optimal where our business is today. So, that's what we're driving for.

**Keith Bachman - BMO Capital Markets**

All right, fair enough. Thank you, Pat.

**Operator**

Our final question comes from the line of Rob Cihra with Evercore. Your line is open.

**Rob Cihra - Evercore**

Hi, great. Thank you very much. If I can ask two questions too because [fattened]. Just on the 14th quarter can you I don’t know give us any sense of how much you think that just mathematically boosted if at all your September quarter numbers? And then secondly just I wanted to check back on -- it sound I guess that you guys were going to pick the buyback up, again I wasn't sure if that was the message or not, but you guys had been obviously super aggressive back at Analyst Day it sounded like you were moderating, but now it sounds like you are planning to pick up back again, I just want to clarify that? Thank you very much.

**Steve Luczo**

Well, I don't know how much more to clarify it. We said at these levels, we believe the stock is well valued and we’ll be opportunistic about accelerating above the base plan.

**Rob Cihra - Evercore**

Okay.

**Pat O'Malley**

And then on the 14th week as opposed to the quarter, it seems like it was 14 quarters but…

**Rob Cihra - Evercore**

I am sorry, yes, 14th week. Yes.

**Pat O'Malley**

Yes, but the 14th week, it’s easy to cost what it runs to do that business; we did see some tapering off in the last week of the quarter which would tie to what Steve said last quarter that a lot of OEMs tied to quarterly deals, may not look it as ‘14 or ‘13 week. So, marginally, I’d say if you do the math on just the cost, it’d actually be a little bit of drag. But we really don’t look at it that way; we look at 26 weeks over the next 27 and we thought it was a good quarter performance of lining up cost and revenue.

**Steve Luczo**

Okay. And then just one thing, there was a question earlier about the non-core businesses, I thought it was related to the systems business when I said it was an over 200, if we met the systems business plus LSI, then and it was over 200, so just to be clear on that.

**Rob Cihra - Evercore**

Okay.

**Operator**

And I am not showing any further question -- I am sorry that does conclude today’s question-and-answer session. I’d like to turn the call back over for closing remarks.

**Steve Luczo**

Yes, good. Just want to thank everyone, our customers, our suppliers, employees, and our shareholders. And we look forward to speaking with you next quarter. Thank you.