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Seagate Technology Holdings Plc (STX)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, everyone, and welcome to the Seagate Technology Fourth Quarter and Fiscal Year 2022 Conference Call. All participants will be in a listen-only mode [Operator Instructions] After today's presentation, there will be an opportunity to ask questions [Operator Instructions] And also note today's event is being recorded.

And at this time I'd like to turn the conference call over to Shanye Hudson, Senior Vice President, Investor Relations and Treasury. Ma'am, please go ahead.

Shanye Hudson

Senior Vice President-Investor Relations and Treasury, Seagate Technology Holdings 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 June quarter and fiscal year 2022 results on the Investors section of our website.

During today's call, we'll refer to GAAP and non-GAAP financial measures. Non-GAAP figures are reconciled to GAAP figures in the earnings press release posted on our website and included on our Form 8-K that was filed with the SEC. We've not reconciled certain non-GAAP outlook measures because the material items that may impact these measures are out of our control and/or cannot be reasonably predicted. Therefore, reconciliation to the corresponding GAAP measures is not available without unreasonable effort.

Before we begin, I'd like to remind you that today's call contains forward-looking statements that reflect management's current views and assumptions based on information available to us as of today and should not be relied upon as of any subsequent date. Actual results may differ materially from those contained in or implied by these forward-looking statements as they are subject to risks and uncertainties associated with our business.

To learn more about the risks, uncertainties, and other factors that may affect our future business results, please refer to the press release issued today and our SEC filings, including our most recent Annual Report on Form 10-K and Quarterly Report on Form 10-Q as well as the supplemental information, all of which may be found on the Investors section of our website. As always, following our prepared remarks, we'll open the call for questions.

Now I'll hand the call over to Dave for opening remarks.

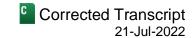
William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Thank you, Shanye, and welcome to those of you joining us on today's call. Our June quarter financial results reflected near-record data center demand, contrasted with impacts from a confluence of macro headwinds in other end markets, particularly in the consumer-facing legacy markets. We believe the secular data trends driving long-term demand growth for mass capacity storage and infrastructure remain intact, as I will discuss a bit later. However, the impacts from COVID lockdowns in Asia, non-HDD component shortages, and global inflationary pressures intensified late in the quarter.



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Our resulting June quarter revenue and non-GAAP EPS declined quarter-on-quarter to \$2.63 billion, and \$1.59, respectively. While macro events are weighing on our near-term performance, Seagate's financial achievements for fiscal 2022 were noteworthy.

We grew revenue by 9% year-over-year fueled by 24% growth in our mass capacity products. We expanded profitability even faster than revenue leading to fiscal year non-GAAP gross margin above 30% and non-GAAP operating margin above 18%. And we achieved record non-GAAP EPS of \$8.18.

In fiscal 2022, we generated \$1.3 billion in free cash flow, our highest level in four years. And maintained our commitment to returning cash to our shareholders funding \$610 million in dividends and repurchasing 9% of our shares outstanding.

We are also demonstrating technology leadership and executing our product roadmap to support the growing demand for data. We attained our fastest ever ramp with the 20-plus terabyte nearline platform handily beating the projections that we made at the start of the quarter. We are on track to achieve volume and revenue crossover with the 18-terabyte drives in the current quarter.

The 20-plus terabyte product family is based on our highly successful common platform design which has enabled us to scale and ramp to yield quickly as evidenced by the results I just shared.

We have the flexibility to extend into the mid to upper 20-terabyte capacity points with minimal changes to our design which allows us to meet customer's timing, readiness, and offers an attractive cost profile for both customers and for Seagate.

We have worked tirelessly over the last three to four years improving the resilience of our supply chain, aligning our mass capacity product portfolio to our customers' needs and strengthening our financial foundation.

Our operational execution combined with structural changes that have taken place in the industry, namely the transition of mass capacity products and increased supply discipline, support our view that the company is fundamentally stronger today and better positioned for the future.

Let us now turn to the current market environment. Despite the ongoing impacts of COVID lockdowns and supply challenges, mass capacity revenue was flat quarter-over-quarter due in part to the strong cloud customer adoption of our 20-plus terabyte nearline drives.

US cloud data center demand remained strong. However persistent non-HDD component shortages have led to inventory imbalances precluding new data center build-outs from being completed. These, along with other supply disruptions, have led to a built-up in inventory levels across a broad spectrum of customers, a trend that continued through the end of the quarter.

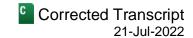
As macro uncertainties and inflationary pressures intensify, we expect customers will increasingly focus on reducing their inventory levels while maintaining the ability to address end market demand.

At the same time, our Asia-based cloud customers are dealing with the impacts of COVID restrictive measures which have had far-reaching effects across all of the end markets that we serve in the region.

In the VIA markets, recall that many of the major projects driving demand are in the Asia region, particularly in China, where lockdowns are impacting our near-term revenue.



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While the situation remains fluid, we are confident that mass capacity demand growth will resume once lockdowns ease and inventory levels normalize.

Within the legacy markets, demand rapidly deteriorated at the end of the quarter as lockdowns and surging inflation severely impacted consumer spending for PCs and external drives. Exiting the June quarter, the legacy business represented only 20% of our HDD revenue which is a historic low.

In response to the current business conditions Seagate is taking actions to maintain strong supply discipline and a favorable pricing environment. We are reducing our manufacturing production plans while continuing to focus on driving efficiencies in the factory and across supply chains. We are maintaining prudent cost controls across the business and executing our product roadmap, which also helps to support our customer's TCO objectives.

While the current environment is challenging, the multiple secular drivers fueling long-term demand for mass capacity storage have not changed and, in fact, continue to expand.

Digital transformation is still in the early innings according to leading cloud service providers who have estimated that only 10% of corporate IT has moved to the Cloud.

New AI applications continue to emerge with AI engines requiring a massive amount of new data for training, data that must be captured, analyzed, stored, and moved across the more distributed multi-cloud network.

And as the digital and physical worlds begin to converge, enterprises are employing data intensive digital twins to enhance decision-making and overall business efficiencies.

These trends dovetailed into a view that businesses will need technology investment strategies to remain competitive in a data-driven world, which includes the need for mass capacity storage and infrastructure.

Seagate is poised to benefit with a broad product portfolio of cloud and edge infrastructure solutions for mass capacity HDDs to enterprise systems to our Lyve Cloud and mobile service offerings.

We are executing our development plans for the 30-terabyte-plus product family based on our innovative HAMR technology, which enables capacity points of 30, 40, 50 terabytes and beyond to support future data demand growth.

Seagate's innovation extends beyond our HDD technology leadership. We're garnering recognition for our systems portfolio, capturing the coveted Product of the Year Award for Hardware Infrastructure at this year's NAB show for our CORVAULT storage system.

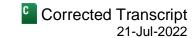
CORVAULT has also gained customer attention with its unique autonomous drive regeneration technology, which combines our device and systems expertise to enable self-healing capabilities. These systems provide enterprise CIOs with peace of mind that their data will be protected while offering a strong TCO value proposition.

Additionally, technologies such as self-healing, distributed data protection and secure arrays play a critical role in reducing the environmental impact of our products.

Drives with these technologies can be repaired, reused, or recycled rather than just discarded, thus helping to preserve the earth's precious resources. These efforts are critically important to Seagate and a key pillar of our



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product circularity strategy. We are also receiving very positive feedback from customers on a global basis for our work in this area.

In closing, Seagate has broad exposure to the strong secular tailwinds driving demand for mass capacity storage. These trends remain intact which lends confidence that growth will resume as supply constraints and COVID lockdown impacts ease.

Seagate is fundamentally a stronger company today and is exceptionally well-positioned to endure the current market environment. We have the right product portfolio, deep customer relationships, and operational agility to optimize profits and fuel growth.

I'll now hand the call over to Gianluca to discuss the financial results.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

Thank you, Dave. While demand for our mass capacity products remain very healthy in the June quarter, the intensifying economic pressure, buildup of inventory at our customers, and COVID-restrictive measures that Dave discussed earlier had a more significant impact on our result than we were anticipating, particularly in the legacy business.

Despite lower than anticipated revenue levels and extraordinary cost pressures, our non-GAAP gross margin expanded slightly to 29.3% in the June quarter, with HDD gross margin remaining comfortably inside our target range of 30% to 33%. Our results are due in part to steady demand for our mass capacity product and a mix shift toward higher capacity drives.

In the June quarter, total hard disk drive capacity shipments increased slightly to 155 exabyte, of which the mass capacity market made up 90% of the total, with shipments of 139 exabytes, up 4% sequentially and 12% year-over-year. Our nearline product contributed 119 exabyte, up 1% sequentially and 17% year-on-year, bolstered by strong US cloud customer demand for our 20-plus terabyte product family. With richer mix of high-capacity nearline drives supported record total HDD capacity per drive of 7.8 terabyte compared with 5.4 terabyte just one year ago.

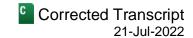
On a revenue basis, mass capacity represented 80% of total HDD revenue at \$1.9 billion in the June quarter, flat compared to the prior quarter and slightly higher than the prior year period. Strong US cloud demand combined with the sequential improvement in the VIA market albeit off very weak March levels offset lower than expected sales into the Asia cloud market which have also been affected by COVID lockdowns. While we believe the end market demand disruptions are temporary, we are mindful of prevailing macro uncertainties which influence how quickly the VIA and other mass capacity markets will return to strong annual growth.

Within the legacy market, revenue was \$489 million, down 24% sequentially and 43% year-over-year.

The decline was most pronounced in the client PC end markets, which now represent a mid-single-digit percentage of our overall revenue. Consumer demand also deteriorated more than anticipated, reflecting the sharp rise in inflation, impacting consumer discretionary spending.

Finally, revenue for our non-HDD business was \$218 million, down about 8% sequentially and 21% year-over-year. We saw a sharp uptick in our system business as we were able to mitigate some of the component shortages we have been experiencing which enable us to begin shipping some of the record order backlog.

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However, component availability remains a challenge and impacted the SSD business during the quarter, leaving us unable to fulfill all the customer demand. We continue to work with our suppliers to support customer demand as constraints ease.

Moving to our operational performance, non-GAAP gross profit in the June quarter was \$771 million, corresponding to non-GAAP gross margin of 29.3%, up 10 basis points quarter-over-quarter. As noted earlier, the increased mix of mass capacity products and transition to higher capacity drives more than offset lower business volumes and higher component costs. Non-GAAP operating expenses were \$349 million, slightly up quarter-over-quarter and in line with our expectations as business travel and sales and marketing activity resumed.

Our resulting non-GAAP operating income was \$422 million or 16.1% of revenue. We will continue to focus on managing cost and balancing supply with demand to position the company to expand operating margin back into the target range of 18% to 22% when top line growth resumes, which we believe could begin later in the fiscal year. Based on diluted share count of approximately 217 million shares, non-GAAP EPS for the June quarter was \$1.59.

Moving on to the balance sheet and cash flow, inventory increased to approximately \$1.57 billion and we ended the quarter with higher finished good, consistent with the rapidly changing business environment. We continue to maintain higher level of critical components and use ocean freight to reduce logistic cost and support future product demand. Based on our current outlook, we're expecting inventory to decline slightly as we move through the calendar year.

Capital expenditure were \$72 million for the quarter and totaled \$381 million for the fiscal year or just over 3% of fiscal year revenue, reflecting our focus on aligning supply and demand. Given the current business environment, we will continue to carefully manage our investment and supply.

Free cash flow generation was \$108 million in the June quarter, down from \$363 million sequentially due to a combination of factor, including higher inventory levels, the timing of certain receipt and linearity, which was heavily weighted to the back end of the quarter. These impacts should normalize in subsequent quarters.

Overall, we are pleased with our free cash flow for fiscal 2022, which increased 13% year-over-year to approximately \$1.3 billion. We currently expect continued growth in our annual free cash flow generation in fiscal 2023, depending on the pace of economic recovery.

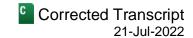
Consistent with our commitment to returning cash to shareholders, we used \$152 million for the quarterly dividend and \$486 million to repurchase 6 million ordinary shares, exiting the quarter with 210 million shares outstanding and approximately \$2.4 billion remaining in our authorization.

Over the past two years, we have repurchased more than 20% of Seagate share outstanding at an average price of approximately \$71 per share. We ended the fiscal year with cash and cash equivalents of \$615 million and total liquidity was approximately \$2.4 billion, including our revolving credit facility.

Total debt balance at the end of the quarter was relatively flat, with the prior period at \$5.6 billion. Adjusted EBITDA was \$2.5 billion for fiscal 2022, resulting in total debt leverage ratio of 2.2 times.

As we enter fiscal 2023, we expect macro uncertainties and non-HDD component shortages to continue pressuring our end markets over the near-term. Drawing on our decades of experience in managing the company

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through dynamic industry environment, we are taking action to carefully manage our cash and safeguard profitability, including managing our supply to restore healthy customer inventory level.

With that in mind, our outlook for the September quarter is as follow. We expect revenue to be in a range of \$2.5 billion, plus or minus \$150 million. At the midpoint of our revenue guidance, non-GAAP operating margin is expected to be slightly above 15% and we expect non-GAAP EPS to be in the range of \$1.40, plus or minus \$0.20.

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

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Thanks, Gianluca. Last quarter, I expressed confidence in the long-term growth trajectory of our business and that view holds firm today. The multiple secular trends fueling demand for mass capacity HDD storage also catalyzed growth for our system solutions and Lyve services business, and Seagate is well-positioned to benefit.

Our products are founded on our drive innovation, and we continue to execute our strong HDD product roadmaps. We're shipping the 20-plus terabyte family of nearline drives in high volume and we are well down the development path towards launching our 30-plus terabyte family of drives based on HAMR technology. We expect to begin customer shipments of these HAMR-based products by this time next year.

Seagate will navigate through the near-term market dynamics by focusing on what we do best, namely run efficient and predictable operations, partner closely with our customers, put in place prudent spending controls, and align supply with demand. We believe that these actions position us to quickly return to our long-term financial model once these macro pressures abate, delivering 3% to 6% revenue growth and operating margins of 18% to 22% of revenue, all the while maintaining our commitment of returning capital to shareholders. While the dynamic market environment is disrupting typical demand patterns, the underlying demand for data remains strong, which supports flat or even slightly higher revenue in fiscal 2023, depending on the timing and pace of the economic recovery.

I'd like to conclude by expressing gratitude to our employees for their incredible efforts through the fiscal year. I'd also like to thank our suppliers, customers, and partners for their contributions to our results and our shareholders for their ongoing support. Gianluca and I will now take your questions.

QUESTION AND ANSWER SECTION

Operator: Ladies and gentlemen, at this time, we'll begin the question-and-answer session. [Operator Instructions] Our first question today comes from Aaron Rakers from Wells Fargo. Please go ahead with your question.

Aaron Rakers

Analyst, Wells Fargo Securities LLC

Yeah. Thanks for taking the question. I guess I want to go down the path on the nearline business. As you look back over this past quarter relative to the 119 exabytes that you had shipped, I guess the first part of the question is did that play out largely as you expected? Did you see demand slow down at all through the course of the quarter? Any kind of changes relative to your initial expectations coming into the June quarter? And how are you currently kind of thinking about the demand profile of that end market considering your comments on inventory as you kind of look at your current quarter guidance? Thank you.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Hey. Thanks for the question, Aaron. If I look at where we were two quarters ago, predictability of the cloud 20 terabyte transition, those kind of tactics that you referred to, I think it's been a fairly predictable through the end of last quarter. We do see, in particular in China in some of the CSPs, some inventory overages.

So what we're doing to try to compensate for that is to not - make sure we don't pack into it, not building too many 16s and 18s, if you will, and hurrying up the transitions to the 20s there. So it's more of a looking forward where I see issues. It's not really with US CSPs. I mean everyone's having the same supply chain issues out in the world, but some people are navigating it differently and I think there's good market demand out for mass capacity and especially in the cloud businesses. I do think there are some temporary issues that people are getting through given their supply chain points or COVID lockdowns or things like that.

Aaron Rakers

Analyst, Wells Fargo Securities LLC

Yeah. And any thoughts on how we think about the end demand? I know in the past, we've talked about kind of a longer term growth rate in that nearline market being kind of in that 30%-plus range. Do you think that to kind of get back to that flat to slight revenue growth into or for fiscal 2023 that that's how we should kind of think about the demand profile into the back half of the fiscal year? Is that kind of how you're thinking about it?

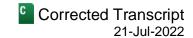
William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Yes. We're going to pause a little bit because – make sure the inventory flows through here in the front half of the year, but we'll eventually get back on that. And we do have products coming, higher capacity points which actually helps drive the exabyte demand as well as this is - as this - customers wake up. Maybe they were stuck on 16 before and now, they're going to be at 20 or 20-plus, right? So that will help the exabyte demand as well.

Ultimately, we're going to be driving out of the back of this fiscal year, like we said, 30 terabytes. So we should get back to some healthy exabyte growth, but I think what we're seeing right now is very tactical.

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Aaron Rakers

Analyst, Wells Fargo Securities LLC

Okay. Thank you.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Thanks.

Operator: Our next question comes from Wamsi Mohan from Bank of America. Please go ahead with your question.

Wamsi Mohan

Analyst, BofA Securities, Inc.

Ah, yes. Thank you and thanks for taking my question. Dave, you mentioned return to growth later in the fiscal year. I was hoping you might give us some color around how you're thinking about the trajectory or recovery both in mass capacity. Are you assuming that you basically have a two-quarter sort of slowdown here as inventory gets worked down and the demand headwinds abate? And is gross margin going to be following a similar trajectory? So are we sort of at the bottom of gross margins or should we expect gross margins to contract further from here? Thank you.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Thanks, Wamsi. I'll let Gianluca answer the gross margin point. From a demand perspective, the legacy was hit pretty hard as we talked about in the prepared remarks and that's – there are a lot of the legacy products that are – the inventory is too high now and things like PCs is so de minimis as a part of our portfolio now that we're probably not going to pack anything into it. But some of the legacy products will suffer this quarter and then they'll come back a little bit.

On the stuff that's more salient for us now because 80% is mass capacity, there still are some things like the VIA market that are not going through their normal seasonality gyrations. They're actually more impacted just because of COVID lockdowns and so on. But we do think that after we get through that period whether that starts at the end of F Q1 or F Q2, we don't know right now, but we think that there's a lot of pent-up demand that's coming.

And so that's one of the reasons what we're doing is we're changing over from some of the more – the older products that might be going end of life to some of our newer products like the 20-plus terabytes, some of the mid-cap nearline products, just making sure that the inventory that we do have is more current. And when those customers are ready for the strong pulls again then we have the best stuff out in front of them. Gianluca, you want to talk about gross margins?

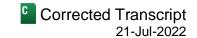
Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

Yeah. Clearly, we are positive on our expectation for the business to recover soon and to improve sequentially. I think seasonality will be different than what we have seen in the last year, for example.

I will say mass capacity is actually strong already. We have done five consecutive quarters of record or near record revenue and volume and gross margin. Actually, the trend in gross margin is a bit different, depending

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from which segments you are looking at. The legacy part and the non-HDD part have seen some decline in gross margin the last four quarters. The mass capacity part has been very strong so, at the total level, you don't see a lot of change because the increase in mix through the mass capacity basically is offsetting the decline for the legacy and the non-hard disk. But, in future, with continuing improvement in mainly mass capacity and the mix continuing to go into the now 80%-plus of the total hard disk being mass capacity, that should bring an improvement in gross margin too.

Wamsi Mohan

Analyst, BofA Securities, Inc.

Okay. Thank you so much.

Operator: Our next question comes from Krish Sankar from Cowen & Company. Please go ahead with your question.

Krish Sankar

Analyst, Cowen & Co. LLC

Yeah. Hi. Thanks for taking my question. The first one is for Dave. You mentioned the US CSPs are pretty strong. How to think about their demand into the calendar second half of this year or do you think that the next shoe could drop?

And then a quick question for Gianluca. You said you have like \$2.4 billion remaining in the buyback, but your cash levels have come down. So how do you think about the sustainability of the buyback over the next few quarters? Thank you very much.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Thanks, Krish. Yeah, I don't think there's another shoe to drop, to be very clear. I think depending on which customer, there may be very specific challenges that they have in their data center built-outs. But, in general, the cloud storage demand growth continues and their CapEx investments continue and so I think, in some places, it's becoming very predictable with them and so that's one of the reasons why we've kind of established the business as we have as we pivoted over mass capacity.

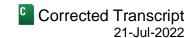
It's interesting. Right now, I think most of the capacity transitions that we're talking about with 20 terabytes and beyond are the people we still have yet to transition are the people who are in the markets that are actually most impacted by some of the COVID shutdowns and things like that. So that's the way I think about it if that helps and then Gianluca can answer the question.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

Yeah. We are very committed to our shareholder return program and so to boost the dividend and the share buyback, as you said, we still have \$2.4 billion of – as amount authorized for our share buyback. Our free cash flow in fiscal Q4 was lower than what we were expecting, for the reason that I explained in the remarks. Of course, we expect free cash flow to improve strongly too in the next few quarters and that will help us to continue our shareholder return and also increase our cash balance.

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Krish Sankar

Analyst, Cowen & Co. LLC

Thank you very much. Thank you.

Operator: Our next question comes from Timothy Arcuri from UBS. Please go ahead with your question.

Jason Park

Analyst, UBS Securities LLC

Hi. Thanks a lot. This is Jason on for Tim from UBS. Just a couple questions. So my first one is as you noted, there has been a lot of concerns around weakening consumer demand. I know consumer legacy market is still a much smaller portion of your business than nearline market, but how can we think about the trajectory of your legacy businesses in terms of exabyte shipment for the second half of this calendar year? Also, could you provide the same color on the VIA market in terms of exabyte shipments as well? And I have a follow-up. Thank you.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Thanks, Jason. So, on the legacy demand, the consumer-facing – so, for example, the USB drives and the like, been a strong market through the COVID work-from-home period. Right now, the consumers in the world have decided that they're spending money on other things. I think everyone knows this around – you can see these consumer spending patterns in many, many different markets and we're not immune to any of that. I think that's some of the stuff that we have to make sure we pull back and position the right inventory.

Those markets, in particular, are not going away. They may be slowly going down but they're not like the PC or notebook markets which are effectively already gone. So we wouldn't have to debit those markets anymore because they're effectively gone.

Mission-critical has been a little bit choppy through the COVID period. It is slowly declining as well but it has a long tail, so that's another place where there's probably a little bit too much inventory. So when we lump it together in those legacy markets, they will have longer tails that we're talking about now because the ones that were going to go to zero effectively already gone there so Gianluca, you...

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

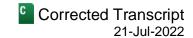
Exabytes were fairly low in the June quarter. We expect September, as Dave was saying, not to be a strong quarter for legacy. Usually, it is the quarter where you see some improvement from seasonality. We don't see this happening this year. But [ph] I think (00:33:37) December is a quarter where you will see some improvement and then the second part of the fiscal year should continue to trend fairly well.

Jason Park

Analyst, UBS Securities LLC

Got it. Thank you and my second question is on the product roadmap. Your main competitor shared some color on their 20 and 22 terabyte product plans where they're expecting the [ph] 20 close (00:34:02) over by the end of this year [indiscernible] (00:34:04). So I was wondering if you could share any color or timelines on your product ramps for 20 and 22 hard drives. Thank you.

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William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Yeah. We said in the prepared remarks that our 20 would cross over relative to our 18, if you will, this quarter, so the quarter we're in right now. So we're ramping the 20 very hard. We met the fastest growth target that we ever had before. We had said that a couple quarters ago and we've actually met that, very happy with the 20-plus terabyte family.

There's a lot of variants of this family. There are variants that continue to be CMR. There's variants that are SMR. Those drives are out there in the world, various places. As a matter of fact, I think I said last quarter that most of the 20s are actually being used above 20 because of some of these variants. So, we're fairly happy with how that's latching out in the world. It's already at high volume and with small changes, we can continue that a little bit. To the conventional platform, we don't need any major technology transitions. With the bigger change to the heads in media and the recording channel and so on, by the end of the year, we'll take that platform to 30 terabytes.

So we're very confident in our product portfolio. We don't really talk about all the details of 2022, 2023, whatever people are using [ph] things at (00:35:24) because I don't think that's setting the right narrative. It's more just we want to make sure that we have flexibility with our platform that we're on today and then launching the 30 terabyte platform in the future with all the technology that comes in there, we're confident in and we're driving it as hard as we can.

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Analyst, UBS Securities LLC

Thank you very much.

Operator: Our next question comes from Patrick Ho from Stifel. Please go ahead with your question.

Patrick J Ho

Analyst, Stifel, Nicolaus & Co., Inc.

Thank you very much. Maybe Dave, first off, on the big picture basis, you talked about introducing HAMR technology at 30 terabytes next year. Given the common platform that you have that you mentioned, about 20 terabytes and the mid-20s and the upper 20s, how do you correlate the demand trends from your customers in supplying these very attractive cost-efficient drives that you just talked about along versus, say, the 30 terabyte HAMR drives which I assume are going to be a little more costly in its initial ramp?

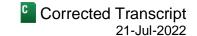
William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Yeah. Thanks for the question, Patrick. So it is a question of what can you make in high volume, where do we get our scrap and yield and since there are so many heads and disks in there, our complement-readiness for the ramp is critical in our margins.

And then going to the 30 terabyte, there are cost-adders. There's a number of different technology transitions not just for the writer of the HAMR, if you will. The media has to change. The reader has to change. All the platform things that electronics, server mechanics, everything that gets you to 30 terabyte has to change.

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So we're very confident in that but how faster we make that turn, that's a good question. A lot of it is our ability to go work the yields and scrap and cost to the point where we need to be. I think from a customer perspective, that's a fairly big jump from one to the other. And the TCO benefits when you think about building a data center and running it for five to seven years, you're willing to entertain the discussion and then the more positive feedback you see on those initial drives, the more you'll be able to drive it hard.

We've had customers that are working with us on these technologies for a number of years now and I think when we launch the product, I think they'll be very open to those discussions because they see tremendous benefit as well. So, I think balancing all these things is exactly the point of what we have to do in our operations and that's where we're focused on.

Patrick J Ho

Analyst, Stifel, Nicolaus & Co., Inc.

Great. That's helpful. And just as my follow-up question for Gianluca, in terms of the cost pressures from COVID, elevated component costs, logistics cost, how much of an impact was it this past quarter and how do you see, I guess, those additional basis points pressure on a going forward basis?

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

In the June quarter, we had a lot of cost pressure not only from COVID but also for inflation. Some of our component costs have increased. As you have seen, we were able to keep the gross margin stable as it's slightly up quarter-over-quarter despite lower revenue. So we are taking our measure to offset the majority of those cost increase. Mix is also, of course, very important to us. I would say for the future, the part that is coming from inflation is probably not going to abate very quickly. So we probably expect the same impact for the next several quarters.

On the COVID side, on the logistic side, we have seen a little bit of improvement in the June quarter compared to the prior quarter. But I think I said in the past that the COVID cost was about 200 basis point of our gross margin. For June, it was probably around 150. This is not, of course, including all the extra costs coming from inflation.

Patrick J Ho

Analyst, Stifel, Nicolaus & Co., Inc.

Great. Thank you very much.

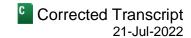
Operator: Our next question comes from Toshiya Hari from Goldman Sachs. Please go ahead with your question.

Toshiya Hari

Analyst, Goldman Sachs & Co. LLC

Hi. Thanks so much for taking the question. Dave, you talked about cutting production. I was hoping you could expand on this, I guess, specifically in terms of utilization rates. Where do you expect to be over the coming quarters relative to the past couple of quarters? And I guess given the production cuts and given how you're vertically integrated, I guess I'm a little positively surprised by how well gross margins are hanging in. I guess what are some of the offsets that you're incorporating in your September quarter guidance?

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William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Yeah. Thanks for the question. I think I'll ask Gianluca to break down some of the F Q1 bridge, if you want, on gross margins. But let me give you a little perspective.

Where we see too much inventory in the chain is in some of the markets that we were planning on building towards, and we don't want to do that. If I've learned one lesson in my life, it's when you see too much inventory, don't pack into it.

It's exacerbated a little bit by the linearity of the last quarter was poor and that therefore almost by definition, you go to the next quarter and linearity is poor again. And especially in these times when you get out to the back of the quarter, you don't have opportunity to cross-ship because freight and logistics lanes are choked and that drives cost. We're trying to put on a little bit more inventory so that we can use ocean freight. It becomes very problematic and so that's one of the reasons why we're intentionally not packing into it.

Relative to the build plans, yes, by slowing things down on some lines, that does have some financial impact. What we're really doing is pivoting over since the lead times – wafer lead times are quite long. Product lead times are quite long for, say, 20 terabytes. Pivoting more towards 20 terabytes and beyond or pivoting more towards the new mid-cap nearline drive, we can do it. It just doesn't happen very quickly.

And so the factories are still relatively full, if that helps exactly your question. You don't see as much absorption hit net-net even though you're taking down the old products as pushing out the new. But there's an intention around not pushing too much into the chains, not having to price that stuff to move eventually into customers that really don't need the product right now.

Now, let's say this is where inflation is playing a role for everyone because you have the CFOs of those companies saying, hey, slow down a little bit and we have to be able to help our customers do that. Gianluca, you want...

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

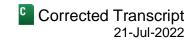
Yes. We will have some costs coming from the underutilization, but we also have an increase in the volume from our 20 terabyte sequentially and that is positive for the gross margin. I also have to say the pricing environment, especially in the mass capacity, is still very favorable. So, we don't see – despite the decline in revenue, we don't see a major impact to our gross margin and profitability in general.

Toshiya Hari

Analyst, Goldman Sachs & Co. LLC

Great. As a quick follow-up, I guess to your last statement, Gianluca, just on the overall pricing environment, generally speaking when demand softens and you've got access inventory in the system, there's typically downward pressure on pricing. But at the same time the industry overall has been very disciplined the past I guess several quarters, if not couple of years, you've got inflationary pressures as well. So, I guess you've got an incentive to potentially pass through some of those inflationary pressures. So, net-net, how should we think about pricing across the legacy markets and mass capacity over the next couple of quarters? Is there a possibility for you guys to raise pricing or is that difficult just given the demand backdrop? Thank you.

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Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

Right, first of all we need to align supply and demand which is now what they were saying before. When there is extra inventory in the business, we need to reduce our supply so that demand and supply are well-aligned. When we have that alignment, of course, the pricing environment gets better. And so right now we are in the situation of transition from, let's say, in high inventory to a more healthy business situation, and then, of course, during the rest of the year when demand comes stronger and we're aligned to our supply, we will take any possible action on pricing, but we will look at that later during the year.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

I think this is where the LTAs have served us pretty well over time to understand all of the macroeconomic inputs and like I always say some of the procurement people that are sitting on the other side of the table from us are -- they understand what's going on in commodity pricing and freight just as well as we do. So we work together to come up with a predictable outcome. We believe in the mass capacity markets at least there's going to be a strong rebound coming and everyone factoring all these things in, I think it serves us well to know exactly what we're building, what we've qualified in, and what we'll apply, and so that's what we're trying to do right now is to change -- is to pivot the operations towards that future line.

Toshiya Hari

Analyst, Goldman Sachs & Co. LLC

Great. Thank you.

Operator: Our next question comes from Steven Fox from Fox Advisors. Please go ahead with your question.

Steven B. Fox

Analyst, Fox Advisors LLC

Hi. Thanks. Good afternoon. Two questions, please. First of all, Gianluca, any help on what you're thinking for CapEx spending this fiscal year. And then secondly, Dave, given that you basically were surprised negatively just a few weeks ago, I'm just trying to understand the biggest factors that make you come out and say that you should start to see a recovery in a couple of quarters. You've touched on a few things, but just maybe give us a sense from about where that confidence is going at, one, demand pulls up on the data center side and, two, that you're not overbuilding into like what could be even a worse macro. Thanks.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

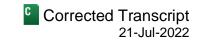
On the CapEx side, as you have seen, we have already reduced our spending in fiscal Q4. Probably for fiscal year 2023, I don't want to change the range. I think 4% to 6% of the revenue is a good range, but for sure, we'll be in the lower part of the range and similar to what we have done in fiscal 2022.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Yeah, and I think longer-term discussions with our customers, the bigger the customers there are, the more convicted they are on their ultimate need to add capacity because they're the ones that manage cloud storage. Some of the customers that are having – I've mentioned a few people that are smaller CSPs that are having some of the inventory issues, we're working closely with them to make sure that we transition to the right product set so

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we don't build the wrong thing into it, and that's a very tactical thing. That's why we have conviction that this thing is going to be over pretty soon. We're all cognizant of all the macro trends and watching them every day, so I don't want to gloss over that. But I think, as far as demand for data products, I do think there will be a rebound coming when all these issues abate.

Steven B. Fox

Analyst, Fox Advisors LLC

Great. That's helpful. Thank you.

Operator: Our next question comes from Erik Woodring from Morgan Stanley. Please go ahead with your question.

Erik W. Woodring

Analyst, Morgan Stanley & Co. LLC

Awesome. Thanks for taking the question. Maybe, Gianluca, any comments you can just share on cash flow thoughts as you move into this next fiscal year after a strong 2022, should we expect growth may be similar to your comments on revenue or just maybe help us parse out how to think about that? And then I have a quick follow-up. Thanks.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

Well, free cash flow, as you said, was good in fiscal 2022. We increased about \$200 million over fiscal 2021. We gave an indication of what we have set for the revenue in fiscal 2023, and knowing that comes through, free cash flow will continue to increase, would be the same level of this improvement in fiscal 2022, maybe even a little bit higher.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Especially at these times, we'll manage cash very carefully, but we also see if the mass capacity rebound is what we're projecting that we should be able to continue to grow cash flow.

Erik W. Woodring

Analyst, Morgan Stanley & Co. LLC

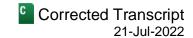
Okay. Super. Thanks for the help. And then maybe along those same lines, Gianluca, just obviously a more challenging macro environment but any comments you can help us to help us better understand kind of how you're thinking about OpEx as the quarterly run rate is still kind \$350 million or any puts and takes that you can help share there would be great. Thanks.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

Yeah, I think between \$350 million and \$360 million will be the range through the fiscal year. We have done a strong control of the OpEx in the last two or three years already, so we think we start from a good point. September is a month where we have our annual salary increase. So we expect a little bit of increase starting basically the December quarter, but still in that range \$350 million to \$360 million should be the right range for us.

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Erik W. Woodring

Analyst, Morgan Stanley & Co. LLC

Awesome. Thanks, guys.

Operator: And our next question comes from Sidney Ho from Deutsche Bank. Please go ahead with your question.

Sidney Ho

Analyst, Deutsche Bank Securities, Inc.

Thank you. I had a quick clarification. I think, Gianluca, you talked about expecting revenue growth could resume later in the fiscal year, but you're not necessarily meaning the December quarter which means I guess is that right. But my question is when I look at the inventory adjustments at your customers whether in the PC or elsewhere, what is your thinking about when they will get to the equilibrium point that your customers stop draining inventory and what gives you that kind of confidence?

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

I'd say, in general, no, we're trying to use this quarter to realign inventory, of course, as you said, it doesn't depend only from us but we're reducing our production and now we're taking a fairly low revenue in the quarter in order to do this realignment. So I would say, after that, we actually expect to increase revenue sequentially. So, December should be better than September quarter. And to achieve the revenue that Dave indicated in his prepared remarks, we need to have a fairly good level of revenue in all the three quarters after September.

Sidney Ho

Analyst, Deutsche Bank Securities, Inc.

Okay. Great. Maybe I'll just jump into my second question. There's a lot of questions on cloud already, but I'm curious on the enterprise OEM side of the nearline business. Last quarter, you mentioned you were limited by non-HDD supply shortages. I'm just curious are you seeing any changes in demand on that side of the business and does that business also as covered by the LTA as your cloud customers. Thanks.

William David Mosley

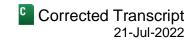
Chief Executive Officer & Director, Seagate Technology Holdings Plc

Yes is the answer to your question, to your last question. It's a little bit more complicated than some of the cloud customers. But what I would say, for example, in our prepared remarks on the Systems business, we talked about how we saw a flood of the components that we needed to go chase after revenue and we did that. That's because I think some of the supply-demand picture is changing very rapidly. The things that we're constrained components six months ago may not be constrained anymore because of a lot of macro issues. It's not completely all clear yet, there are still component shortages that are affecting the enterprise.

I think also the spending reductions by again I always say nervous CFOs which are talking to the CIOs of the world, that's I think impacting us a little bit right now as well. Look, long term, I believe that on prem enterprise is going to be healthy because there is going to be hybrid clouds not just in the public cloud, but also in the private cloud as well. And so I think those will be strong businesses there.

They still – there are various challenges there, supply-related still, and I think some of that will start to break free over the next six months.

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Sidney Ho

Analyst, Deutsche Bank Securities, Inc.

Okay. Thank you.

Operator: Our next question comes from C.J. Muse from Evercore ISI. Please go ahead with your question.

C.J. Muse

Analyst, Evercore ISI

Yeah. Good afternoon. Thank you for taking the question. I guess two questions. First, you talked on the call about excess inventory in the channel for your various end markets. I was curious if you could rank order perhaps worst to best by end markets where you get a flavor of where things need to correct. And then I guess specifically for US data centers, you talked in your prepared remarks around the correction there. It sounds like it's a handful of players. Could you provide perhaps more color on what you're seeing there and when you think that will start to recover for you? Thanks so much.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Yes, C.J., let me just make sure I got all this right. So the first one was rank order. I think China generally has the biggest impact. There's impact in distribution channels worldwide, consumer and disk D. So Europe, Americas, they are both down significantly year-over-year, and that's part of the macro malaise that we've been talking about.

The China itself has not only that but also the VIA markets and some of the cloud service providers. There is inventory challenges each place, I think, that we're staring at. Working through it with those customers. Some of that is macro. Some of it is COVID lockdowns. There is kind of just trepidation in the market because some of the lockdowns happened and then they go for reopening, they pull inventory in, and then they can't reopen. I think the world's going to get through these things but we just have to kind of wait it out. Can you ask the second part of your question again?

C.J. Muse

Analyst, Evercore ISI

Yeah, sure. In your prepared remarks, you spoke to what I thought I heard was inventory correction at select hyperscale plays. And so I guess did I hear that correctly? And then if you could provide more color on your expectations for that to be cleared out.

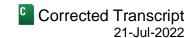
William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

I don't think there's too much inventory problems at US hyperscalers. I think everyone's having supply challenges, not necessarily hard drives or whatever. There's maybe – maybe the way I would characterize it is to say that there is pent-up demand for data storage in a lot of markets. And once the world gets through all of these supply challenges, whether they're power supplies or chassis or compute or Memory or whatever it is. For the each one individual I think we'll be in a better place. People are working on this very hard and everyone's got their own challenges.

But I think we're -- that's the thing that the world is just not firing on all cylinders like it was maybe three or four years ago, and I think we will be able to get back to reach some kind of equilibrium over time.

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C.J. Muse

Analyst, Evercore ISI

Very helpful. Thank you.

Operator: Our next question comes from Thomas O'Malley from Barclays. Please go ahead with your question.

Thomas O'Malley

Analyst, Barclays Capital, Inc.

Hey, guys. Thanks for taking my question. My question was just on the long-term agreement that you guys talked about on the call here. When Micron took down numbers, they were asked specifically about whether those long-term agreements were take or pay, and they kind of talked about the fact that they can't really force customers to take their product. What did you guys the confidence that when you're looking at the back half of this year, your customers aren't going to walk away from those long-term agreements if the market looks a little bit worse than it does today.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Yeah. Thanks, Tom. I kind of agree with what you said. We have to work with our customers on these things. I said -- I think last quarter I talked about co-planning more. It's just how many units do you need, what kind of products need to be qualified? And it has to go out further because as we're making 20-plus terabyte products or even starting 30-plus terabyte products we do need to know exactly how many the customers are willing to take and how much to use our factory, use inside our factories.

If something else happened, then I think we'd have to work it through with the customers at the time. So it's not really take or pay. And from my perspective, the customers have been great working through that. Just trying to give us the right visibility, and we hold each other accountable on both sides of the table there is working pretty well.

Thomas O'Malley

Analyst, Barclays Capital, Inc.

Great. And then just my follow-up is even if you do assume some accelerated growth in the back half, obviously the inventory is working down so that helps a bit. Free cash flow does become a bit challenged. If you were to look at an environment in which free cash flow from a quarterly perspective goes negative, can you just talk about your rank order of capital returns? Do you think that you would buy back less stock first or do you think that you would rationalize the dividend? Can you just talk about priorities there in terms of where you'd be cutting first and if the environment kind of persists like it is.

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

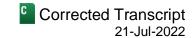
So, I don't see that coming through. I don't see any quarter where our free cash flow will go negative. So, I don't know, we have a capital allocation strategy. As I said before, we want to stay focused on shareholder returns. I think our free cash flow will be strong in fiscal year 2023, I don't see now the situation you are showing here.

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

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Yeah, the way I would say, Tom, is that we're going to go work the cash flow. We had some period -- very specific things that Gianluca talked about in Q4. I think we can go recover some of those things over time. And some of it's too much inventory like I said for making sure we're building the right things. I think once we get through that period I think we are going to be just fine from a cash flow perspective and even have the opportunity to grow it year-over-year. We have a lot of levers that we can still continue to control.

Thomas O'Malley

Analyst, Barclays Capital, Inc.

Great. Thank you, guys.

Operator: And our next question comes from K. Cassidy from Rosenblatt Securities. Please go ahead with your question.

Kevin Cassidy

Analyst, Rosenblatt Securities, Inc.

Thanks for taking my question. Yeah, just two quick questions. With all the long-term agreements you have in place, what are the lead times or what is the visibility that you are getting from your customers? And second is, are you seeing any change in the trends of lockdowns in China?

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Yeah, it's -- thanks, Kevin. There's different kinds of LTAs depending on the market, depending on which specific customer under appetite typically six months to a year, the visibility that we're working together.

And it's -- over the last few years it's gotten longer, so that's good. Just making sure we have the right products stage for what they're going to need at that point in time with predictable economics for them and so on and us.

Relative to China, I think I made a comment earlier, even our own factories have been impacted recently. So making sure that we're doing the right things for the employees, not working them at places where we don't need the materials and things like that is the challenge.

I personally think that things are already getting better, but I also think part of the problem is that -- we've said that 3 or 4, 5 times and people have pulled inventory against a reopening, if you will. It's not even -- it's not a matter of what you're capable of in your factory, it's also what your customers are ready for.

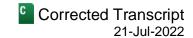
And whether you can get the -- just like in the front end of COVID, whether you can get people in to build the data centers and all these other things that are going on. The thing I'm focused on the most is the small business aspect of talking to some of our customers about people who have to actually go in and do the builds in the smart city builds, the smart buildings, hospitals, things like that, that's where any kind of lockdown just really throws that for a loop.

And I do think that we're going to continue to see some of it a little bit and then we're all looking for improvements in Q2 and it's going to have to break free at some point. So...

Operator: And our final question today comes from Vijay Rakesh from Mizuho. Please go ahead with your question.



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Vijay Raghavan Rakesh

Analyst, Mizuho Securities USA LLC

Yeah. Hi. Thanks. Hi, Dave and Gianluca. I know you guys mentioned slightly higher inventory levels. Just wondering if you could help us level-set what the inventory levels were, let's say, in China versus – or in Asia versus the US. And is there expectation that the inventory normalizes within the quarter here because I think you've talked about maybe December quarter revenues start to improve?

William David Mosley

Chief Executive Officer & Director, Seagate Technology Holdings Plc

Right. We're taking actions to make sure it improves this quarter. Gianluca made the point earlier. I don't think it'll improve all the way, but we'll get the lion's share of what we need to get done this quarter. And again depending on the pace of some of these recoveries like COVID and some of the other pressures that people are feeling it'll happen faster. And the important thing for us is that we make sure that we pivot the customer qualifications and our products towards the stuff that's more modern, that's higher margins for us, that we can make the people actually want to buy that we don't have to go disrupt the market any more.

Vijay Raghavan Rakesh

Analyst, Mizuho Securities USA LLC

Got it. And I think you mentioned utilization level. I mean, I believe you indicated when the gross margins would be flat sequentially, is that right, given that utilization still stay high with the 20-terabyte ramping I guess, right, even as you talked to us on the supply back, is that the way to look at it?

Gianluca Romano

Chief Financial Officer & Executive Vice President, Seagate Technology Holdings Plc

We did not guide directly gross margin, but I was answering to a question. I said, well, there is a negative impact in the September quarter because of some underutilization costs, but there is also positive impact coming from higher 20-terabyte. And I also said the pricing environment is also still favorable, so overall we don't see major changes to our profitability.

Vijay Raghavan Rakesh

Analyst, Mizuho Securities USA LLC

Got it. Great. Thanks a lot. Thank you.

Operator: And, ladies and gentlemen, at this time I'd like to turn the floor back over to management for any closing remarks.

William David Mosley

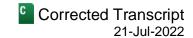
Chief Executive Officer & Director, Seagate Technology Holdings Plc

Thanks, Jamie. I'd like to take the opportunity to once again thank our employees for their incredible efforts and recognize our suppliers and customers for their ongoing support this quarter. It's a challenging environment across the ecosystem and we appreciate all of your partnerships. Likewise, I appreciate our shareholder community for your ongoing trust in Seagate.

Seagate will continue to take actions to manage through the current macro dynamics. So, over long term, I'm confident that the secular demand for mass capacity storage and infrastructure remains high. And I remain excited by Seagate's opportunities to deliver value for all the stakeholders. So, thanks for joining us, everyone.



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Operator: And, ladies and gentlemen, with that we'll conclude today's conference call. We do thank you for joining. You may now disconnect your lines.

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