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NetApp, Inc. (NTAP)

Q4 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to NetApp's Fourth Quarter and Fiscal Year 2017 Results Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. [Operator Instructions]

I would now like to turn the call over to Ms. Kris Newton, Vice President, Corporate Communications and Investor Relations. Ma'am, you may begin.

Kris Newton

Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

Hello, and thank you for joining us on our Q4 Fiscal Year 2017 Earnings Call. With me today are our CEO, George Kurian; and CFO, Ron Pasek. This call is being webcast live and will be available for replay on our website at netapp.com, along with the earnings release, our financial tables and guidance, a historical supplemental data table, and the non-GAAP to GAAP reconciliation.

As a reminder, during today's call, we will make forward-looking statements and projections with respect to our financial outlook and future prospects, such as our guidance for the first quarter and full fiscal year 2018 and our expectations regarding future revenue growth, improved profitability, cash flow and shareholder returns, all of which involve risk and uncertainty. We disclaim any obligation to update our forward-looking statements and projections.

Actual results may differ materially from our statements and projections for a variety of reasons, including the macroeconomic and IT spending environments, and our ability to successfully innovate in the growth areas of the market, gain market share, expand our operating margin, and continue our capital allocation strategy.

Please also refer to the documents we file from time to time with the SEC, specifically our most recent Forms 10-Q, our Form 10-K for fiscal year 2016, and our current reports on Form 8-K, all of which can be found on our website. During the call, all financial measures presented will be non-GAAP, unless otherwise indicated.

I'll now turn the call over to George.

George Kurian

President, Chief Executive Officer & Director, NetApp, Inc.

Thanks, Kris, and good afternoon, everyone. The fourth quarter marked a strong finish to fiscal 2017 for NetApp. Our continued focus and disciplined execution yielded yet another quarter of solid results on the top and bottom lines. Revenue for the fourth quarter was at the high end of our guidance range with both operating margin and earnings per share above our guidance. We have returned the company to revenue growth, with improved profitability and earnings by innovating to redefine traditional markets, bring enterprise-grade technology to emerging areas of the market, and meet the evolving needs of our growing customer base, we are creating new opportunities for NetApp, gaining market share and expanding our addressable market.

When I became CEO, I set three priorities for the business: pivot to the growth areas of the market; reduce the cost structure of the company; maintain a robust capital allocation program. This intense focus has helped us systematically improve our execution and drive efficiency through the business and ultimately meet or beat our goals.

We have successfully delivered against each priority and have effectively completed the first phase of our transformation. I'll provide more detail on this first phase, and then share some perspective on the focus areas for the next.

Consistent with the plan we've laid out, the headwinds from mature solutions, add-on hardware, OEM and ONTAP 7-Mode are lessening. In Q4, product revenue from mature solutions declined 7% year-over-year. Going into FY 2018, the transition from 7-Mode to Clustered ONTAP is largely behind us, and we have renewed focus on hardware and software OEM opportunities. These both will further moderate the decline in mature solutions. Strategic solutions, which position us to lead in the new era of IT, were 70% of net product revenue, up 24% year-over-year. By emphasizing our Data Fabric strategy and our flash-enabled, cloud-integrated strategic solutions, we've driven a reacceleration of the business.

Our success in pivoting to the growth areas of the market is evident, not only in the shift of our product revenue to strategic solutions, but also in the mix of our systems business, the majority of which now comes from products in the high growth All-Flash Array market. We are in the early innings of the movement to flash, and have a significant growth opportunity ahead as we penetrate our install base and displace competitors' installations with our all-flash solutions.

Clustered ONTAP allows customers to modernize the infrastructure by replacing standalone silos of storage and monolithic frame arrays with a scale-out, software-defined shared storage platform, delivering seamless enterprise data management across flash, disk, public and private clouds. We have successfully migrated over 50% of the capacity and almost 50% of the FAS systems in our large install base to Clustered ONTAP. In Q4, Clustered ONTAP was deployed on 95% of FAS systems shift. And as I noted earlier, the transition from 7-Mode to Clustered ONTAP is now behind us.

NetApp leads the industry in the transition to flash with cloud-integrated solutions that provide unrivaled efficiency, speed, scale and data management. We strengthened our number two position in calendar year 2016, and our growth continues to outpace the market and competitors both large and small. We have entered into an agreement to acquire Plexistor, a company with technology and expertise in ultra low latency persistent memory. This differentiated the intellectual property will help us further accelerate our leadership position and capture new application types and emerging workloads.

For customers looking to modernize existing data centers, All Flash FAS deployed as both FAS engineered systems and FlexPod Converged Infrastructure solutions is the clear choice. We have been very successful replacing legacy frame array solutions from our competitors in Tier 1 SAN deployments, accessing a new market for us by disrupting it with flash. In 2016, NetApp was the fastest growing of the leading SAN suppliers, a clear indicator that we are moving outside of our traditional install base and expanding our opportunity.

In Q4, our All-Flash Array business grew almost 140% year-over-year to an annualized net revenue run rate of $1.7 billion, inclusive of All Flash FAS, EF and SolidFire products and services. We are winning with flash and expanding our intellectual property in this market, positioning us for success in the multiyear transition from disk to flash. The All Flash FlexPod and our momentum in the channel helped to strengthen our number two position in the Converged Infrastructure market and contributed to the 44% year-over-year growth of FlexPod revenue reported in IDC's Quarterly Converged Systems Tracker for calendar Q4 2016. We also recently acquired Immersive Partner Solutions, a cloud-based converged infrastructure monitoring and compliance company. We will integrate this intellectual property into our FlexPod solutions to help customers further simplify and automate lifecycle management and enhance our leadership in the Converged Infrastructure market.

We are growing the SolidFire business at an accelerating pace through continued innovation and expanded reach. The FY 2017 revenue performance of SolidFire was in line with the expectations we laid out at the time of acquisition, and SolidFire was significantly less dilutive to our overall operating results than we expected. On our last earnings call, we announced that we are further leveraging our SolidFire investment and expanding our growth potential by developing the next-generation of hyperconverged infrastructure. Development is on track, and we look forward to sharing more details later this quarter.

Enterprises, cloud service providers and partners choose NetApp because we enabled their hybrid cloud strategies through our Data Fabric architecture. The NetApp Data Fabric delivers consistent and integrated data management services and applications for data insight, access, control, protection, and security, enabling customers to unleash the full power of their data. We displaced Dell EMC at a cloud service provider with our All Flash FlexPod solution for its SAP HANA implementation. That customer chose NetApp because of our value and industry-leading functionality. We helped the leading wine producer and distributor realize the hybrid cloud strategy with the All Flash NetApp Private Storage for Cloud, ONTAP Cloud, and OnCommand Insight to manage it all.

Key requirements of this transaction were a cloud strategy and the ability to manage complex migrations. OnCommand Insight allows customers to look at disparate storage environments in their data center and increasingly in the hybrid cloud to make decisions about where they want to optimize resources. The strength and focus of OnCommand Insight allows us to displace legacy competitive solutions, and it is now the leader in the Storage and Device Management market.

Ron will go into the details about our cost reductions, but I'm pleased to announce that we overachieved in our goal of delivering a net run rate savings of roughly $130 million in OpEx and cost of sales. More importantly, we've made good progress towards focusing the business, driving disciplined portfolio management, and systematically generating more efficiencies, while setting a high bar for execution. Our capital allocation program includes the balance of shareholder returns and investment in the business.

In FY 2017, we returned over $900 million to shareholders in the form of share buybacks and dividends. Additionally, we made organic and inorganic investments to support the long-term growth of the business like the development of our HCI solution and continued innovation in all-flash arrays and hybrid cloud solutions.

Having successfully completed the first phase of our transformation, we will now drive the second phase, delivering sustained growth in the fast growing parts of the market, while maintaining a focus on margins and productivity. Again, we will focus on three priorities. First, we will expand our total addressable market by growing our portfolio and the ways we deliver it. Strengthening our leadership position in all-flash arrays and converge infrastructure markets, continuing to push into Tier-1 SAN opportunities, introducing our HCI solution as well new cloud services and partnerships, reinvigorating our OEM program and addressing new buyers in new ways.

Second, we will continue to make fundamental changes to drive productivity, enabling further investment in the business while continuing to expand our operating margins. And third, we will continue our robust capital allocation program, which includes a combination of shareholder returns and investment for the long-term growth of the business.

FY 2017 was a pivotal year for NetApp, we started the year with bold commitments and we delivered against all of them. We did what many said could not be done, return the company to growth while simultaneously expanding operating margins.

With each successful step in our transformation, my confidence in our ability to create new opportunities and execute against those opportunities grows. As an independent player of scale, our openness creates a unique opportunity to partner broadly for successful customer outcomes. The mix of our business is weighted more towards the fastest growing parts of the market than our traditional competitors and we have significantly greater technology differentiation, customer relationships and scale in those growth areas than the new players who are trying to address them.

As we enter FY 2018, we are building on a strong foundation and are without question, the best positioned and the best executing in the industry.

I'll now turn the call over to Ron to walk through our Q4 and fiscal year 2017 financial performance and go forward expectations. Ron?

Ronald J. Pasek

Executive Vice President and Chief Financial Officer, NetApp, Inc.

Thanks, George, and good afternoon, everyone. As a reminder, I'll be referring to non-GAAP numbers today unless otherwise noted. NetApp delivered a strong finish to fiscal 2017. Our results clearly demonstrate the substantial progress we're making toward transforming the business, driving sustained growth, and addressing the rapidly changing market. Before discussing our full year results and future expectations, I'll provide detail on our performance in the fourth quarter.

Q4 net revenues were at the high end of our guidance at $1.48 billion. As we anticipated, the growth of our strategic solutions more than offset the declines in our mature solutions and started driving net revenue growth in the second half of 2017. The year-over-year Q4 net revenue growth of more than 7% is clear evidence of this dynamic.

Product revenue of $852 million grew over 12% year-over-year led by flash and the continued strength of our strategic solutions. The combination of software maintenance and hardware maintenance and other services revenues increased 1% year-over-year. Gross margin of 62.5% was 1 point better than Q3 and above our guidance range. Product gross margin of 48.9% increased about 3 points sequentially and 2 points year-over-year, reflecting improved sales discipline, fewer promotions and lower ENO reserves.

Software maintenance gross margin was roughly flat sequentially and increased just over 1 point on a year-over-year basis. Hardware maintenance and other services gross margin decreased over 1 point sequentially but increased over 2 points year-over-year, reflecting the benefits from our transformation initiatives. Operating expenses of $690 million increased 7% sequentially reflecting higher variable compensation due to higher-than-expected revenue growth. Despite slightly higher operating expenses, our operating margin of 20.7% was above our guidance range.

Our effective tax rate for the fourth quarter was 22.1%, an increase of 3.5 points sequentially reflecting a higher mix of U.S. profits. We ended the quarter with $278 million weighted average diluted shares outstanding. EPS of $0.86 exceeded the high end of our guidance range by $0.02 as a result of higher revenue and higher gross margin. Cash and balance sheet metrics remained healthy in the quarter. Our cash conversion cycle improved 13 days year-over-year, reflecting 24 days of combined improvement in DSO and DPO from our transformation initiatives partially offset by a 10-day increase in DIO.

Additionally, cash flow from operations grew 6% year-over-year to $365 million. Deferred and financed unearned services revenue declined 1% year-over-year due to lower ASPs, and to a lesser extent, execution issues within renewals. Free cash flow grew 5% year-over-year to $327 million.

Inventory returns decreased by nine turns on a year-over-year basis reflecting increased flash inventory and timing. To reiterate, we're confident that we have secured adequate NAND supply to meet anticipated demand for the remainder of this calendar year. We have a unique advantage through our deep business and technical partnerships with our NAND and SSD suppliers. We partner to help them bring their new technologies to market faster, and consequently, maximize our continuity of supply.

We repurchased $129 million of NetApp shares and paid $51 million in cash dividends during the quarter. Finally, we ended the year with approximately $4.9 billion in cash and short-term investments, with roughly 9% held by our domestic entities.

Now turning to our full year 2017 results. Net revenues of $5.52 billion were relatively flat compared to fiscal 2016. Gross margin of 62.3% was relatively flat compared to the previous year and was within our guidance range. Operating margin of 17.2% improved almost 4 points versus fiscal 2016, and was above our guidance range of 15% to 17%.

In fiscal 2017, we took important, and in some cases, difficult steps that were necessary to lower our cost structure and improve the alignment of our resources to our strategy. We committed to reducing our cost structure across both cost of sales and OpEx, yielding a net annualized run rate savings of $130 million after investment in SolidFire and other growth areas of the business.

I am pleased to report that we exceeded this commitment, achieving annualized net run rate savings of approximately $140 million despite the impact of higher variable compensation in Q4. Our effective tax rate was 19.2% and 1.5 points above expectations reflecting the higher mix of U.S. profits.

EPS of $2.73 for the full year increased 28% from 2016. We continued to deliver on our capital allocation strategy through a combination of dividends and share repurchases in excess of $900 million we returned over a 110% of free cash flow to shareholders this year. Additionally, we have completed over $1.7 billion of a $2.5 billion repurchase program we announced in February of 2015. We remain firmly committed to delivering shareholder value and are on track to complete the remaining $800 million by the end of May 2018. Today I am pleased to announce a 5% increase in our next cash dividend to $0.20 per share which will be paid on July 26, 2017.

Now to guidance. I am confident that we're making the right investments to compete and win, not only in the market segments where we are strong today, but also in the new high growth areas of the market. We're making tough decisions and key investments to expand our TAM and drive strong financial performance over the long term.

Looking ahead to fiscal 2018, we expect moderated revenue growth to ramp throughout the year consistent with our normal seasonal trends. We are forecasting a gross margin range of 62% to 63% and expect operating margin in the range of 18% to 20%. We are committed to delivering low double-digit EPS growth and expect our effective tax rate for the year to be approximately 19% to 20%.

Additionally, we expect to continue generating meaningful free cash flow in the range of 17% to 19% of revenues, enabling us to invest in growth as well as continue to return significant capital to our shareholders in fiscal 2018. With that in mind, I'd like to take a moment to remind you of seasonal trends relating to our operating margin. We typically build momentum through the fiscal year. As such, Q1 is generally our softest quarter for operating margin, reflecting seasonally lower Q1 revenue, as well as seasonally higher operating expenses mainly from salary adjustments.

That said, now on to guidance for the first quarter of fiscal 2018. We are forecasting a revenue range of $1.24 billion to $1.39 billion. At the midpoint, this implies year-over-year revenue growth of approximately 2%. We expect gross margins of approximately 62% to 63%. We're targeting Q1 operating margins of 13.5% to 14.5%, reflecting the seasonality I just discussed.

We expect EPS to be between $0.49 and $0.57. This implies a 15% growth year-over-year at the midpoint, which is consistent with our typical Q1 contribution to full year EPS, and consistent with the long-term model of low double-digit EPS growth that I shared with you at our recent Analyst Day.

In closing, I'm very pleased with NetApp's performance in fiscal 2017. We've sharpened our focus, accelerated our innovation, and are shifting the investments toward the fastest-growing parts of the market, while accelerating our ability to deliver shareholder value through improved profitability and cash flow. The substantial progress we've made drives my confidence in NetApp's growth potential and future.

With that, I'll hand it back to Kris to open the call for Q&A. Kris?

Kris Newton

Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

We'll now open the call for Q&A. Please be respectful of your peers and limit yourself to one question so we can get to as many people as possible. Thanks for your cooperation. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from the line of Andrew Nowinski with Piper Jaffray. Your line is now open.

Andrew James Nowinski
Analyst, Piper Jaffray & Co.

Q

All right. Great. Thanks for taking the question and great, great quarter again. So your product gross margin improved nicely again this quarter, and I think you mentioned fewer promotions. Can you just give us any color on the promotions that you're no longer using and then maybe [ph] weave in (24:58) color on how you're competing against Dell EMC as it relates to pricing? Thanks.

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Sure. I think we hinted at this at our Analyst Day. There was a cDOT promotion we had run for quite some time and we were very clear that it had pretty much run its course, and it in fact did. That definitely helped. As well, I think there were a couple other things that contributed including better sales execution and discipline, and we didn't have the charge that we had in Q3 of 2017 as well.

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

We've also introduced a new class of high value products and ONTAP 9.1 software that continues to differentiate our portfolio. So overall, strong new products differentiation there, continued sales force discipline and execution, as well as removing the Clustered ONTAP migration program now that the majority of the migrations are done.

With regard to EMC, as we said we have competitive programs in place and we see continued momentum from those comparative programs. In Q4, we accelerated the rate of EMC takeouts to one a day, and we mentioned that it was once every few days at the Analyst Day. I think in Q4 we've accelerated that to once per day, representing the fact that we've got the best all-flash array portfolio in the market.

Andrew James Nowinski
Analyst, Piper Jaffray & Co.

Q

Great. Thanks a lot.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thank you, Andy. Next question.

Operator: Thank you. And our next question comes from the line of Brian White with Drexel Hamilton. Your line is now open.

Brian J. White
Analyst, Drexel Hamilton LLC

Q

Yes, George. Could you talk a little bit about the trends you're seeing in the U.S. public spending vertical for the quarter and maybe for orders moving forward? I know one of the big OEMs highlighted weakness in that vertical over the past week. Thank you.

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

We had a good quarter in public sector representing both market share gains, as well as execution by our field organizations. I would tell you that the outlook for public sector depends on the budget that the new administration passes. I think we have a broad book of business in the public sector market. So my sense is that it's too early to tell but defense is probably strengthened and civilian is probably hampered a little bit by the – if the budget passes the way it's shaped. But we've got a broad book of business and we continue to demonstrate leadership and execution in that market.

Brian J. White
Analyst, Drexel Hamilton LLC

Q

Great. Thanks.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thanks, Brian. Next question.

Operator: And our next question comes from the line of Sherri Scribner with Deutsche Bank. Your line is now open.

Sherri A. Scribner
Analyst, Deutsche Bank Securities, Inc.

Q

Hi, thanks. Ron, you mentioned that you expect revenue growth to moderate – be – I think you said moderating revenue growth through the year. Can you talk a little bit about what that means exactly. I think the midpoint of your guidance is just 1.6% revenue growth. Is revenue going to accelerate as we go through the year or is it going to be kind of in these same levels? How are you thinking about that as we progress through the year? Thanks.

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

What I try to say, Sherri, is coming off of Q4 where we grew 7%, down to Q1 where we're seeing a roughly 2% year-over-year growth, we do expect that to accelerate through the year.

Sherri A. Scribner
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thanks, Sherri. Next question.

Operator: And our next question comes from the line of Aaron Rakers with Stifel. Your line is now open.

Aaron Rakers
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah, thank you. At the Analyst Day, you talked a little bit about the penetration rate of your customer base that shifted to all-flash, I'm curious if you could give us an update with regard to that, and how we should think about that looking at over the next 12 months, where you think that possibly could go.

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

I think we're in the early innings of the transition to all-flash. I would tell you, our total opportunity is, not only within our install base, where all-flash systems are less than 10% of our large and growing install base, but also in displacing competitor frame arrays and legacy storage environments. So we are in the early stages of a multi-year transition from disc to flash, and we feel very well positioned to capitalize on that market transition.

We are the fastest growing vendor in the all-flash array market, outpacing our competitors large and small. I think if you look at our numbers, we're up 140% year-over-year as compared to others who are in the 30% range. And if you look quarter-on-quarter, we're up 24% as opposed to them down sequentially in the same range. So we feel very, very good about our portfolio.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thanks, Aaron. Next question.

Operator: Our next question comes from the line of Jayson Noland with Robert W. Baird. Your line is now open.

Jayson A. Noland
Analyst, Robert W. Baird & Co., Inc.

Q

Okay, great. I wanted to ask on the revenue guidance, you mentioned, accelerate through the year, can you grow product revenue for F 2018?

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Well, coming off a quarter in Q4 where we did, yes, absolutely. That is the plan.

Jayson A. Noland
Analyst, Robert W. Baird & Co., Inc.

Q

For the full year F 2018 over F 2017, though?

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

Absolutely.

Jayson A. Noland
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. Thank you.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thanks, Jayson. Next question.

Operator: And our next question comes from the line of Kulbinder Garcha with Credit Suisse. Your line is now open.

Kulbinder S. Garcha
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you for the question. I guess, given where you are guiding, it looks like operating margins for the first quarter, you'd have to exit the year probably at peak levels in the low 20%s, I think. Is that the trajectory we should think about or is there more of a step up sooner in the year? Thanks.

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Well, Kulbinder, as you saw this year we started out quite low as well and accelerated from 12% in Q1 of 2017 to over 20% in Q4 of 2017. So yeah, that is the seasonality I was addressing in my prepared remarks, so absolutely.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thanks, Kulbinder. Next question.

Operator: Thank you. And our next question comes from the line of Simona Jankowski with Goldman Sachs. Your line is now open.

Simona K. Jankowski
Analyst, Goldman Sachs & Co.

Q

Hi, thank you. Just a couple of follow-ups on that also. In terms of the outperformance in product gross margins in the quarter, is an element of that driven by increasing prices to pass through some of the NAND cost increases? And then Ron, for the first quarter, you talked about the OpEx seasonality, is there a seasonality relative to gross margin you'd point us to or a mix impact? And then finally, from a long-term perspective, what is the natural product gross margin that you think is realistic for you guys. Can you get back to the low 50%s range? Thank you.

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Yeah. So the first part of your question, Simona. So yeah, I think what we had indicated was that we did raise prices in many of our flash products as a result of NAND prices increasing to us. And so in many cases, we did pass that along. The only seasonality you'll see in gross margin relates sometimes to Q2 on a product basis, we see year-end public sector revenue and margin go up, otherwise it's not that cyclical.

I'd hesitate to give us a long term guide on product margin, it is certainly our intent and I mentioned this at the Analyst Day, that we should be doing better than we are and that is part of our AOP or annual operating plan for FY 2018.

Simona K. Jankowski
Analyst, Goldman Sachs & Co.

Q

Thank you.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thanks, Simona. Next question?

Operator: Our next question comes from the line of Maynard Um with Wells Fargo. Your line is now open.

Maynard J. Um
Analyst, Wells Fargo Securities LLC

Q

Hi, thanks. Can you just talk about the change in your go to market that you talked about in your Analyst Day. How much have you done and any qualitative or quantitative thoughts you can share on what you're seeing? And then similarly, with the compensation structure changes, have you seen any disruptions or any kind of turnover in sales that have been outside the norm? Thanks.

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

I think first of all, the confidence in our employees, customers and reseller partners is exceptionally good. I think the turnaround has been seen positively by everybody and we are attracting the world's best talent in NetApp.

I think in terms of the compensation plan, the coverage model and some of the things that we talked about at the Financial Analyst Day, we recently implemented that at the start of May, which is the plan for the new fiscal year, fiscal 2018, and so we're going to play that out through the course of this year. I think we entered the year with a really strong capacity number in terms of quota bearing heads, which is what we had said that as part of transformation we're going to redeploy investment from non-quota bearing roles to quota bearing roles.

So we feel really good. The momentum in the product portfolio demonstrated market share gains and the right amount of capacity to execute our game plan for this year. And as I mentioned, we intend to grow product revenue year-on-year this year accelerating through the course of the year.

Maynard J. Um
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thank you, Maynard. Next question.

Operator: Our next question comes from the line of Alex Kurtz with Pacific Crest Securities. Your line is now open.

Alex Kurtz
Analyst, Pacific Crest Securities

Q

Yeah. Thanks for taking the question and I apologize if you already touched on this. But when you look at your all-flash growth, can you help us quantify how much of that is coming from the install base refresh over maybe the last nine months or so and how much of that is net new customer growth?

George Kurian

President, Chief Executive Officer & Director, NetApp, Inc.

A

We are gaining new customers, new workloads in existing customers, and the two of them are represented by the fact that we are based on public market data from IDC, for example, the fastest growing major SAN vendor, fiber channel stores vendor, which is a net new market for NetApp. We have converted a small percentage, as I mentioned, of less than 10% of our install base to all-flash arrays. So the majority of our growth is coming from outside our install base.

Alex Kurtz

Analyst, Pacific Crest Securities

Q

Okay. All right. Thank you.

Kris Newton

Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thank you, Alex. Next question.

Operator: Our next question comes from the line of Steven Fox with Cross Research. Your line is now open.

Steven Fox

Analyst, Cross Research LLC

Q

Thanks. Good afternoon. I'm just a little confused on the gross margin guidance, so you're talking about doing 62% to 63% in the first quarter, and then also for the full year even though you're talking about accelerating sales growth. Can you just walk us through some of the puts and takes between Q1 and say the full year guidance? Thanks.

Ronald J. Pasek

Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Yeah. I mean, so we generally see Q1 as fairly flat to Q4. We have a little higher mix of services revenues which usually helps gross margin. However, we do have NAND cost still increasing, so that's a little bit of a headwind. As I mentioned in the Analyst Day, I think that will start to dissipate later in the year and certainly into next year. We're maintaining a fairly conservative range for the year where we're trying some new things with compensation in the sales force, and we want to see them take hold so there – we'll see how that goes I think it can only be upside.

Steven Fox

Analyst, Cross Research LLC

Q

Great. Thank you very much.

Kris Newton

Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thanks, Steve. Next question.

Operator: And our next question comes from the line of Mark Kelleher with D.A. Davidson. Your line is now open.

Mark Kelleher
Analyst, D. A. Davidson & Co.
Q

Great. Thanks for taking the question. You talked about reinvigorating your OEM program, can you maybe talk a little bit about what your plans are there?

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.
A

I think it's too early to comment. I think we do see the opportunity to access new markets and new geographies using both software as well as hardware. So we've succeeded in some of the Smart City projects that are going on in the Asia-Pacific region using a new type of integrator that combines NetApp storage with other components of a broad-based Smart City solution, that's one example. We'll communicate more through the course of the year as news becomes available, but in the broad context is, the combination of software assets from NetApp like ONTAP Select or SolidFire software, as well as the opportunity to create new solutions through new pathways, and makes us believe that OEM is no longer a place which declines, but rather flattens out or starts to grow moderately.

Mark Kelleher
Analyst, D. A. Davidson & Co.
Q

Okay. Thanks.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.
A

Thanks, Mark. Next question.

Operator: And our next question comes from the line of Jane Kisner with Jefferies. Your line is now open.

James Kisner
Analyst, Jefferies LLC
Q

It's James not Jane, just to make sure. So on the – just a clarification and a sort of question on – you mentioned, I think, excess amounts of inventory helping product margin, I want to make sure that that was still helping non-GAAP product margin and maybe you could quantify how much that helped. And then just separately on just the – congrats on the minus 7% better mature solutions declines, are there any particular pieces in that business that outperformed that really helped you with that – I guess to say it differently, what's the product line that did the best year-over-year that drove that result? Thanks.

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.
A

Yeah. So on the – all I was really trying to point out is we had that as a headwind in Q3. It certainly wasn't there in Q4. The main pieces of benefit were of course better sales execution and the removal of the promo for cDOT.

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.
A

I think with regard to the mature solutions, I think first of all, we had said that as the three components of mature solutions were add-on storage, OEM and 7-Mode, and they are increasingly becoming a smaller part of our overall business. So the year-on-year declines in them are frankly smaller than they would be. The preponderant majority of that business is OEM and add-on storage at this point, and therefore those will not be, as I said, subject to the same rate of declines.

7-Mode is now a much, much smaller percentage of our business. If you think about the shipments out of the factory, they're 95% Clustered ONTAP and so we think that mature overall as we had said many times, will be a place of stability or very modest decline going forward.

James Kisner
Analyst, Jefferies LLC

Q

Thanks very much.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

All right. Thank you, James. Next question?

Operator: Thank you. And our next question comes from the line of Mehdi Hosseini with Susquehanna. Your line is now open.

David Ryzhik
Analyst, Susquehanna Financial Group LLLP

Q

Hi, thanks so much. This is David Ryzhik for Mehdi Hosseini. Your anticipation for accelerating product growth throughout the year, does that include new products such as hyperconverged ramping? And the second part of my question is, regarding cDOT migration, what is the strategy with legacy 7-Mode installations given that you're kind of signaling that it's behind us. What is the strategy if any? Thanks.

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

So in respect to ramp of new products, yes. In fact, SolidFire continues to ramp in the year and some other new products that will come along.

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

So we feel good about the portfolio we have to-date, that have – we have just finished a very strong quarter. We think that many of the solutions that we sold this quarter have expanded potential and we'll continue to demonstrate additive innovations to the portfolio over the course of the year, stay tuned. With regard to the customer base, and the partner channel on Clustered ONTAP, we have migrated a substantial percentage of that customer base as we've communicated to clustering from 7-Mode. We have also trained our partner channel and trained our customers to achieve those migrations themselves. So we've given them tools, methodologies and allowed them to shadow us as we've helped them do the migrations.

The remainder of those migrations will happen at the pace that customers take on IT projects. They will be a part of the broader IT agenda of customers and so we feel very good. We've got the big percentage of our install base migrated, we have seen real success with both Clustered ONTAP and all-flash Clustered ONTAP called All-Flash

FAS, and we think that we've established a compelling value proposition for customers to migrate over the remainder of the install base.

David Ryzhik
Analyst, Susquehanna Financial Group LLLP

Q

Great. Thank you.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thank you, David. Next question.

Operator: Our next question comes from the line of Srini Nandury with Summit Redstone. Your line is now open.

Srini Nandury
Analyst, Summit Redstone Partners LLC

Q

All right. Thank you for taking my question. Congratulation on a good quarter. You mentioned on the call that you're taking out EMC once a day, what products are you displacing, are those primarily Dell products or EMC, or both?

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

We are displacing the EMC products, primarily VMAXs and VNXs, as we tear out old SAN environments and replace them with All Flash FAS. We are also looking forward to displacing old Isilon environments with ONTAP 9.2. So we...

Srini Nandury
Analyst, Summit Redstone Partners LLC

Q

All right. Thank you, George.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thank you, Srini. Next question?

Operator: Thank you. And our next question comes from the line of Katy Huberty with Morgan Stanley. Your line is now open.

Kathryn Lynn Huberty
Analyst, Morgan Stanley & Co. LLC

Q

Thanks, good afternoon. Ron, how should we think about operating expense trend for the full year fiscal 2018 in light of R&D for adjacent markets, and some of the go-to-market investments you talked about at the Analyst Day?

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Yeah. So, what I mentioned at Analyst Day for the three-year period, it would have been roughly flat. I also mentioned, we would see a slight bump in 2018, as we will see, given we need to give people raises, but other than that, it's really pretty much flat to what we would have expected.

Kathryn Lynn Huberty
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you.

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Let me clarify one additional thing, Katy, what we're clear was that we'll continue to do transformation, that we would be using that as a tool to disinvest and reinvest in the business, so that the reinvestment is not all incremental.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thanks, Katy. Next question?

Operator: And our next question comes from the line of Amit Daryanani with RBC Capital Markets. Your line is now open.

Amit Daryanani
Analyst, RBC Capital Markets LLC

Q

Thanks a lot, guys. I guess, just a question on the component shortages, and maybe I missed this, but can you quantify what headwind did component shortages or price increases have for you in the April quarter, and how do you think over that headwind in July, and if I understand the structure of your – securing the NAND supply dynamic properly, is it fair to think you've secured the supply but pricing could still fluctuate and could still kind of have a margin impact?

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

That's right. I was hinting at that last quarter, we do secure the supply for the remainder of the calendar year, but we only do pricing for the next 90 days in advance. So, it was about 1 point headwind in the Q4 quarter, it's about 0.5 point as we entered Q1.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

All right. Thanks, Amit. Next question?

Operator: Our next question comes from the line of Rod Hall with JPMorgan. Your line is now open.

Rod Hall
Analyst, JPMorgan Securities LLC

Q

Yeah. Thanks for the question. I just wanted to check on the competitive dynamic, a couple of questions actually on this. One is Dell EMC significantly increased their channel program at the beginning of the year, especially focused on storage. So, I wonder if you could comment on whether you're seeing any impacts from that and then just kind of how that's playing out in the market.

And then I also wanted to talk a little bit about all these price increases. Do you expect others to do the same, and what do you think the impact on market demand is going to be? Your customer is going to pause spending as we get toward the back end of this year, as they think about NAND eventually clearing and prices coming back down, or do you think people will [indiscernible] (45:20)?

And then lastly on NAND, I just want to ask that again, I mean, the data point in the quarter suggested stabilization is not going to happen in the back end of this year as people have thought, at least some of the suppliers are now pushing out supply-demand breakeven into middle or even into next year. So, I wonder if you're thinking that things are going to stabilize at the end of the year, maybe it's a little bit optimistic, just like to get your comments on that.

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

Okay. That's a lot of questions, but let me take them in sequence. With regard to EMC channel programs, we have a strong group of channel partners that do a lot of business with NetApp that are focused on NetApp. I think the success of our All Flash FAS products, the success of our competitive programs, the success of FlexPod in an all-flash configuration are all indications of the strength of our channel and the focus that we have. I think EMC may sweep up some of the marginal partners, but they're not the core focus of our channel program.

The second is, with regard to the pricing dynamics in customers, we are uniquely positioned with Clustered ONTAP to enable customers to move workloads between an all-flash configuration and a hybrid flash configuration that combines flash with disk seamlessly. So we are able to provide customers the choice of both. We did see strength in our hybrid flash platform this quarter as well, but it's too early to tell whether that was a reflection of pricing. It's – it would be remiss of me to speculate on what other people would do. I think we felt that it was important for us to stay consistent to prior practice and future practice that we pass through to customers, the increases in component costs as well as the decreases in component costs as they happen.

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

With respect to NAND suppliers, remember, we have strategic relationships with suppliers that allow us and afford us different dynamics and perhaps other people in the marketplace. So what I said today and previously are still consistent. So, we see our supply being in good shape and should free up later in the year and into next year.

Rod Hall
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Okay. Thanks, Rod. Next question?

Operator: Our next question comes from the line of Nehal Chokshi with Maxim Group. Your line is now open.

Nehal Sushil Chokshi
Analyst, Maxim Group LLC

Q

Thank you. Good quarter. The driver on the pullback of the year-over-year growth for the July quarter, I mean, you had 7% year-over-year growth for the April quarter and you're guiding at a midpoint of 2%, is there a story behind why you're guiding for that pullback on that growth? And I do have a follow-up as well.

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Nothing other than what we indicated at the Analyst Day is that we really are giving realistic, and in some cases, conservative estimates, and we want to make sure we meet or beat every commitment we've made as we have the last four quarters. [indiscernible] (48:30)

Nehal Sushil Chokshi
Analyst, Maxim Group LLC

Q

Okay. Is it possible that the year ago comps is a lot easier than what was for the April quarter, and that's one of the things that's going into that conservatism as well?

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Actually, the year ago Q1, Q1 of 2017 was actually a pretty good quarter. It really was flat for product revenue, it was down slightly on services only because we had a 13-week quarter versus 14-week the year before, so, if anything, it's a more difficult compare.

Nehal Sushil Chokshi
Analyst, Maxim Group LLC

Q

That's what I meant. Okay. Sorry. And then my follow-up is that it looks like revenue from direct pathways took a step back in terms of year-ago growth profile all indirect accelerated. So, is there a story behind what seems to be two different tales for these two different pathways for market?

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

No. Nothing substantive there. I think it's just to make some transactions, timing of transactions, I don't think there's anything systematic. I think we've had a good progress with our channel partners, and we've seen strength in terms of total product revenue growth across both. FlexPod, in particular, we had a really strong year and second half of the year, in particular, with FlexPod through the FlexPod advantage and All Flash FAS program. So, I would say that it's probably reflects more the strength of the indirect channel through that model.

Nehal Sushil Chokshi
Analyst, Maxim Group LLC

Q

Okay. Thank you.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thank you, Nehal. Next question?

Operator: Thank you. And our next question comes from the line of Simon Leopold with Raymond James. Your line is now open.

Simon M. Leopold
Analyst, Raymond James & Associates, Inc.

Q

Great. Thank you. First, I just wanted to clarify within the guidance, I think it seems to imply your operating expenses rise sequentially. And just looking at prior year, sales and marketing sometimes moves up, sometimes moves down on what is typically a seasonally lower revenue quarter. Could you help us understand any of the moving parts that might be influencing OpEx in your July guidance? And then in terms of the broader question, I wanted to ask about the longer-term strategy in terms of all-flash, because you've got hyper-converged product coming to market in three different all-flash platforms. Is there some thought about trying to consolidate those platforms or looking for more synergies or are the synergies there and just not well appreciated? Thank you.

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Yeah. So, on the walk on OpEx from Q4 to Q1, it's simply the fact that we're giving people raises. We are down in Q1 2018 versus Q1 a year ago. And again, we're doing some disinvestments and reinvestments, so that is the really simple explanation. That's it.

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

With regard to your second question, I would say, we have very clear swim lanes and use cases that we describe for our All-Flash Array platforms, and that allows customers to make ongoing purchase decisions with confidence in these road maps. With regard to offerings of both the ONTAP and SolidFire, I would just tell you, we've had a tradition of making ONTAP and SolidFire available as standalone systems as part of Converged Infrastructure, software and as-a-service models, and what you'll see with SolidFire is it's offering in a hyper-converged form factor, so it's consistent with practice. Our customers like the fact that they can operate a storage environment across all these use cases, it gives them a huge return on both training as well as automation and management and monitoring infrastructure, unlike our competitors who have a different operating system for every single use case.

Simon M. Leopold
Analyst, Raymond James & Associates, Inc.

Q

Great. Thank you. That's very helpful.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

All right. Thanks, Simon. Next question?

Operator: And our next question comes from the line of Mark Moskowitz with Barclays. Your line is now open.

Mark Moskowitz
Analyst, Barclays Capital, Inc.

Q

Yeah, thanks, good afternoon. Just want to build off of Rod's question from earlier regarding competitive dynamics. It seems like it could be more than just Dell EMC if we're not mistaken in terms of pure storage starting to gain momentum of FlashBlade and also HP Enterprise acquiring Nimble, it just seems like NetApp now is in the crosshairs of a lot of different targets here or bullseyes [ph] and you had (51:35) players out there. Is this part of the reason why you're being little more cautious in the guide and not really providing a full-year revenue outlook, because you could have a lot more [indiscernible] (52:53)?

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

Not at all. I think we feel real confident, right. If you look at the strategic portfolio, it's accelerated through the year, both in terms of its size as a percentage of our business, as well as growth rate. Just take a look, last quarter, it was up 22% on product revenue, strategic product revenue this quarter, 24%, last year it was 14% at this time. So we feel real good about the product portfolio. I think there's two things, right. I think one is, we want to make sure that when we give you guidance, we can achieve those estimates, and it's really that. And then the second is, we continue to watch the macro, and as we get more color through the course of the year, we'll certainly give you a better outlook as it becomes available, but it has got nothing to do with competitive dynamics.

If you look at our market share numbers in All-Flash Arrays, we're outpacing all these guys. I would tell you that some of the competitor moves our desperation moves to catch us rather than us feeling worried about them.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

All right. Thank you, Mark. Next question?

Operator: And our next question comes from the line of Eric Martinuzzi with Lake Street. Your line is now open.

Eric Martinuzzi
Analyst, Lake Street Capital Markets LLC

Q

Yeah. I may have missed this earlier, but what was the head count, where did you finish the head count with for FY 2017 and what's your expectation for head count for – sorry, finished for FY 2017 and your expectation for FY 2018?

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

So we do not plan to add any net new head count in FY 2018, we finished the year at 10,103 employees.

Eric Martinuzzi
Analyst, Lake Street Capital Markets LLC

Q

Got it. Thanks.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thanks, Eric. Next question?

Operator: Thank you. And our next question comes from the line of Erik Suppiger with JMP. Your line is now open.

Erik L. Suppiger
Analyst, JMP Securities LLC

Q

Yeah. Can you just expand on the Plexistor acquisition, how big was that?

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

It's a small number of employees, it is factored into the operating margin guidance that we gave you. So, it will not be dilutive to operating margins, and at this point, we're not disclosing the terms of the transaction.

Erik L. Suppiger
Analyst, JMP Securities LLC

Q

Okay. Thank you.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thanks, Erik. Next question?

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

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Thank you very much. Maybe I'm doing my math wrong or something, but can you help me out, is your EPS guidance range bigger now than it has been historically in the past, and if my math is correct, can you help us understand why a bigger range?

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Yeah. What we did last year was had a big range to revenue, but it wasn't mirrored in EPS, so all I did was make them equal. So that it's more in line with the broader range we had established for revenue.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Gotcha. Thank you so much.

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Yeah.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Gotcha.

Operator: Thank you. And our next question comes from John Lucia with JMP Securities. Your line is now open.

John A. Lucia
Analyst, JMP Securities LLC

Q

Hey, guys, thanks for taking my question. I just wanted to clarify on the revenue growth acceleration throughout FY 2018, is that total revenue, product revenue or both?

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Both.

John A. Lucia
Analyst, JMP Securities LLC

Q

Okay. And just be clear, again, you expect an acceleration every single quarter, so that Q4 has the highest growth rate, correct?

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

That would be our – well, not necessary growth rate, but it would have our highest – it would be our highest revenue in quarter for the year, and that would be our traditional seasonal pattern. Yes.

John A. Lucia
Analyst, JMP Securities LLC

Q

Okay. And then with respect to the NAND supply, you said that NetApp is well-positioned, because you have the ability to sell the hybrid and bring the price down, given the [ph] HCD (55:27) components. Are customers really adjusting their purchasing decisions because of a slight price increase? It seems like if a customer settles on – in all-flash solution that's a kind of a long-term strategic decision that wouldn't be influenced or changed to go to a hybrid solution by short-term pricing increases, so if you could elaborate on that, that would be helpful.

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

A

Yeah, you know, flash still has – even with an increase in the cost of an SSD on a dollar per gigabyte basis, flash still has compelling advantages from a total cost of ownership, right, density, power consumption, operational benefits. So there's a lot of other reasons why people would continue to choose flash.

I think what we find is, we continued to have the benefit that when we position our solution to customers, they can buy it to an architecture that ensures them against material moves in the price, right. Unlike our competitors who only have an all-flash storage system, we can go and then tell our customer, buy our Clustered ONTAP architecture, and you know what, if supplies of flash goes up substantially for a period of time, you can deploy a disk-based solution or a hybrid solution for those discretionary workloads that absolutely do not need an all-flash environment, right? And that's really how we position it. Flash continues to have material advantages over disk from a total cost of ownership perspective that needs to be factored into the calculations.

John A. Lucia
Analyst, JMP Securities LLC

Q

Okay. Thank you very much.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thanks, John. Next question?

Operator: Thank you. And our last question comes from the line of Wamsi Mohan with Merrill Lynch. Your line is now open.

Wamsi Mohan
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.

Q

Yes. Thanks. Ron, sorry if I missed this, but can you just comment on the OpEx seasonality through the course of the year? Thanks.

Ronald J. Pasek
Executive Vice President and Chief Financial Officer, NetApp, Inc.

A

Yeah, I mean, as I said, we see a little bump up in Q1 simply because we're giving people raises. Absent that, what you tend to see is it follow the essentially variable comp, which will be higher in the second half of the year, and that's really about it. Again, we're in a net zero head count growth environment, so you shouldn't see any growth in head count causing any cyclicality in OpEx.

Wamsi Mohan
Analyst, Merrill Lynch, Pierce, Fenner & Smith, Inc.

Q

Okay. Thanks.

Kris Newton
Vice President, Corporate Communications & Investor Relations, NetApp, Inc.

A

Thank you. Yeah, thank you, Wamsi. I'll turn it back to George for closing comments.

George Kurian
President, Chief Executive Officer & Director, NetApp, Inc.

Thanks, Kris. We successfully completed the first phase of our transformation. We've delivered against all our commitments for fiscal year 2017 and returned the company to growth with expanded earnings growth. We are well-positioned for sustained growth going forward. The majority of our systems business is in the high growth All-Flash Array market, and the market is in the early days of the shift from disk to flash.

Our compelling hyper-converged infrastructure solution will leapfrog the first generation HCI products by bringing HCI to the enterprise with cloud integration and the ability to run multiple workloads on a shared infrastructure. And we continue to expand our opportunity through organic and inorganic innovation.

Entering the next phase of our transformation, we've been focused on three priorities: expanding our opportunity with continued emphasis on the growth areas of the market, the ways we deliver our solutions, and reaching new buyers; making fundamental changes to enable reinvestment in the business, while continuing to drive the expansion of our operating margins as we demonstrated this year; and continuing our robust and balanced capital allocation program.

Thank you to all our partners and shareholders for supporting us during this period of transition. And I want to say a special thank you to the NetApp team for leading into transformation and accelerating our turnaround. I'm proud of our progress, and especially of you, our world-class team. I look forward to talking to you again next quarter.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. And you may all disconnect. Everyone, have a great day.