Dell Technologies Q1, FY'24 EARNINGS CALL

Thursday, June 1st, 2023

Rob

- Thanks everyone for joining us. With me today are Jeff Clarke, Chuck Whitten, Tom Sweet, Yvonne McGill and Tyler Johnson.
- Our earnings materials are available on our IR website and I encourage you to review our materials and presentation which includes additional content to complement our discussion this afternoon. Guidance will be covered on today's call.
- During this call, unless otherwise indicated, all references to financial measures refer to non-GAAP financial measures, including non-GAAP gross margin, operating expenses, operating income, net income, and diluted earnings per share.
- A reconciliation of these measures to their most directly comparable GAAP measures can be found in our webdeck and our press release.
- Growth percentages refer to year-over-year change unless otherwise specified.
- Statements made during this call that relate to future results and events are forward-looking statements, based on our current expectations.
- Actual results and events could differ materially from those projected due to a number of risks and uncertainties, which are discussed in our webdeck and SEC filings. We assume no obligation to update our forward-looking statements.

- Now, I'll turn it over to Chuck.

Chuck

- Thanks Rob.
- Our Q1 results demonstrate our strong execution and the power of our model in what remains an uncertain macroeconomic environment.
- At the summary level, we delivered revenue of $20.9B, operating income of $1.6B, diluted EPS of $1.31 and cash flow from operations of $1.8B.
- Consistent with our commentary in recent quarters, the demand environment remains challenged and customers are staying cautious and deliberate in their IT spending.
- We continued to see demand softness across our major lines of business, all regions, all customer sizes, and most verticals.
- That said, we did see pockets of stronger demand performance worth noting.
    - The CSG business performed sequentially better than our expectations at the time of our Q4 earnings call, and we did see some early signs of demand stabilization in commercial PCs in our small and medium business segments and across our transactional business.
    - In storage, we saw continued demand growth in PowerStore, our marquee mid-range offering, and in PowerFlex, our leading software defined storage solution.

PowerStore has grown for eleven consecutive quarters since its release, and PowerFlex has now grown for seven consecutive quarters.

    - And in servers, we saw an increase in demand for our AI optimized solutions. Interest has been particularly strong for our new purpose built 16G server for artificial intelligence, the PowerEdge XE9680, though we caution that we are early in the demand cycle for AI infrastructure and it will take time to translate to the P&L.

- In what was a challenging demand backdrop, we executed extremely well and stayed focused on what we could control.
- We maintained pricing discipline even as competitors continued to reduce excess channel inventory, our average selling prices increased, and we delivered strong sequential and year-over-year gross margin performance given lower input costs.
- We continued to maintain strong cost controls, reducing operating expenses by 6%. Since Q1 of last year, we have reduced operating expense by $240M and will continue to focus on prudent cost management as the year progresses.
- Our supply chain performed well. We reduced inventory by approximately $800M in Q1 and by $2.3B over the last year, and our lead times and backlog have normalized post-pandemic and ahead of competitors.

- And we are clearly focused on relative performance. We again gained share in calendar Q1 in Commercial PCs excluding Chrome, the most profitable segment of the market and our focus, and we expect to gain share in Q1 in storage when IDC results come out later this month. Though we anticipate some fluctuations in share performance as the year progresses given the timing of industry backlog reduction, we remain confident in our ability to remain a structural share gainer over the long-term.

Innovation

- We also pressed forward on a substantial innovation agenda.
- Last week, we hosted our annual Dell Technologies World event with more than 10,000 attendees and made several big announcements as we advanced our strategies in multicloud, edge, AI, security, hybrid work and as-a-Service solutions.
- In multicloud, we introduced three APEX Cloud Platforms developed with Microsoft, Red Hat and VMware to seamlessly extend public cloud operating environments to on-premise environments.
- We also announced new APEX Cloud Storage for public cloud offerings bringing Dell's industry-leading block and file enterprise storage capabilities to Azure and AWS environments and delivering on the promise of Project Alpine announced last year.

- We delivered on the vision of Project Frontier, introducing Dell NativeEdge, our software platform that makes it easier for customers to manage, simplify and secure their entire edge estate with a single solution.
- We announced Project Helix, our collaboration with NVIDIA that enables customers to quickly deploy generative AI on-premises at scale using their own proprietary data safely and securely.
- Under APEX, we met our commitment to extend as-a-Service capabilities across our full portfolio with the addition of compute and PC as-a-Service.
- And finally, we announced Project Fort Zero, a collaboration with over 30 partners to develop a US Department of Defense validated solution that will ease the adoption of Zero Trust security in private clouds.

Close

- Looking ahead, we expect the cautious IT spending environment to continue in Q2.
- We expect CSG to perform closer to historical sequentials given the pockets of commercial PC demand we saw in Q1 and the duration of the PC downcycle relative to prior cycles.

- We expect Q2 ISG spending to remain muted as customers scrutinize and prioritize spend – though customers continue to move forward with digital investments, sales cycles continue to lengthen given the macroeconomic uncertainty.
- And as the industry inventory levels continue to normalize, we expect an increasingly competitive pricing environment relative to Q1.
- Ultimately we have confidence in the long-term health of our core markets and the advantages of our business model.
- Data continues to increase exponentially in both quantity and value, and customers see us as a trusted partner ready to help them navigate the complexities of multi-cloud, edge, AI, data management and hybrid work.
- We remain the industry leader in all our key solutions categories, are central to our customers' technology agendas, and have a strong track record of delivering on our commitments in any environment.
- So short and long-term, we will stick to the playbook that has served us well across multiple cycles – focusing on customers, driving differentiated relative performance, delivering against our innovation agenda, prudently managing costs, maintaining pricing discipline and investing for the long-term.
- Now over to Tom for the detailed Q1 financials.

Tom

- Thanks Chuck.
- We're pleased with our Q1 execution given the current environment.
- We delivered revenue of $20.9B, down 20%, with strong gross margins and operating cost management.
- Currency remained a headwind and impacted revenue by approximately 290 basis points.
- Gross margin was $5.2B and 24.7% of revenue.
- Gross margin rate was up 2 points driven by lower input costs and pricing discipline.
- We did see increased pricing pressure in Q1 but were selective on deals depending on the customer and the opportunity.
- Expect us to continue to focus on the more profitable segments of the market and remain disciplined on pricing.
- Operating expense was $3.6B, down 6% driven by lower marketing and headcount related costs, and 17.1% of revenue given scaling. We will continue to actively manage our overall spend as we move through the year.
- Operating income was $1.6B and 7.6% of revenue due to a decline in revenue partially offset by a higher gross margin rate and lower operating expense.
- Our quarterly tax rate was 22.7%.

- Net income was $963M primarily driven by lower operating income and to a lesser extent a higher tax rate.
- Diluted EPS was $1.31, down 29% due to lower net income partially offset by a lower share count.
- Our recurring revenue in the quarter was approximately $5.6B, up 6%, and our remaining performance obligations, or RPO, was approximately $39B which was down 7% due to a reduction in backlog partially offset by an increase in deferred revenue.
- Deferred revenue was up primarily due to increases in services and software maintenance agreements.

ISG

- ISG revenue was $7.6B, down 18% driven by soft demand in servers and storage.
- We delivered storage revenue of $3.8B, with demand growth in PowerStore and PowerFlex. While Q1 is seasonally our softest storage quarter, we did see customer decisions extend out and some deal sizes reduced.
- Servers and networking revenue was $3.8B. We saw server ASPs continue to expand and our mix of high value workload servers increased as we continue to sell deeper into customers' digital agenda.
- ISG operating income was $740M or 9.7% of revenue, down two points primarily due to a decline in revenue partially offset by a better gross margin rate.

CSG

- Turning to CSG, the PC market has continued to slow since June of last year, and the market declined sharply in calendar Q4 and again in calendar Q1, down 29% in units.
- Our fiscal Q1 CSG revenue was $12B, down 23%, primarily driven by a decline in units partially offset by higher average selling prices in Commercial and Consumer.
- In a continuation of trends we've seen in recent quarters, Commercial fared better than Consumer. Commercial revenue and Consumer revenue were $9.9B and $2.1B, respectively.
- CSG profitability was strong in Q1 with operating income of $892M, or 7.4% of revenue, up 20 basis points driven by a higher gross margin rate and lower operating expenses.
- We remain focused on commercial and the high-end of consumer, relative performance and executing our direct attach motion for services, software, peripherals and financing.

DFS & APEX

- Turning to DFS and APEX.
- Customer interest remains high in consumption and financing models that provide both payment flexibility and predictability.
- Our Q1 Dell Financial Services originations were $1.8B. DFS ending managed assets reached $14.3B, up 9%, while the overall DFS portfolio quality remains strong with credit losses near historically low levels.

- During the quarter, we continued to see APEX momentum including an increase in the number of APEX customers that have subscribed to our as-a-Service solutions.

Cash flow and B/S

- Turning to our cash flow and balance sheet.
- Our cash flow from operations was seasonally very strong at $1.8B aided by our focus on working capital efficiency.
- As Chuck mentioned, we reduced inventory by approximately $800M in Q1 and by $2.3B over the last year through disciplined execution and improvement in our supply chain, and our receivables balance benefited from strong collections this quarter.
- Our balance sheet remains strong, and we ended the quarter with $9.2B in cash and investments, down $1B sequentially due to $1.1B of core debt paydown and $527M of capital returns offset by free cash flow generation.
- Our core leverage ratio improved sequentially to 1.7x as we prepaid our billion dollar note due in June.

Capital Allocation

- Turning to capital allocation.
- We will continue our balanced approach, repurchasing shares programmatically to manage dilution while maintaining the flexibility to be opportunistic.
- In Q1, we repurchased 6.1M shares of stock for $251M and paid $276M in dividends.

- Now I'll turn it over to Yvonne to cover our guidance.

Yvonne

- Thanks Tom.

Guidance

- Turning to guidance.
- We expect Q2 revenue to be in the range of $20.2B and $21.2B, or between down 3% and up 1% sequentially, with a midpoint of $20.7B.
- Currency continues to be a headwind, and we are expecting a roughly 200 basis point impact to Q2 revenue.
- We expect CSG Revenue to be roughly flat sequentially and ISG down in the low single digits sequentially.
- With inventories normalizing across the supply chain, we expect a more competitive pricing environment.
- Given Q1 profitability combined with more muted sequential component cost deflation, we expect gross margin rates to be down roughly 50 basis points sequentially.
- We expect our Q2 diluted share count to be between 733 million and 738 million shares and our diluted EPS to be $1.10, plus or minus $0.10.

- For the full year, we're maintaining our FY24 revenue expectations, down between 12% and 18% and down 15% at the midpoint. Given Q2 guidance, this implies a return to sequential growth in the second half of the year.
- Interest and other will be up approximately $100 million as we fund DFS originations in a higher interest rate environment.
- For our tax rate, you should assume 24% plus or minus 100 basis points.
- We are increasing our expectation for diluted earnings per share to $5.50 plus or minus $0.25.

Close

- In closing, expect us to continue to be disciplined in how we manage the business in the current macro environment, focusing on what we can control and delivering for our customers.
- While there is near-term uncertainty, we have strong conviction in the growth of our TAM over the long-term.
- We are committed to delivering our value creation framework with a revenue CAGR of 3 to 4%, a diluted EPS CAGR of 6% or higher, and a net income to adjusted free cash flow conversion of 100% or higher over time.

- We have returned $5B to shareholders over the last six quarters through share repurchase and dividends, approximately 96% of our adjusted free cash flow over that time period, well in excess of our 40-60% return target.
- We value our relationships with our shareholders and we are actively listening to your feedback.
- We increased our annual dividend by 12% last quarter and we recently put in place new governance enhancements to our board and oversight structure.
- Ellen Kullman has been elected by our board as lead independent director with robust oversight responsibilities, and all our board committee members are independent directors.
- Also, with recent S&P Global eligibility rule changes, we are encouraged about the potential for future inclusion in the S&P 500 index.
- Now, I'll turn it back to Rob to begin Q&A.