DELL TECHNOLOGIES INC.

Moderator: Robert Williams
Thursday, May 30, 2019
4:30 p.m. Central

Robert Williams Thanks, Ian, and thanks for joining us. With me today are our vice-chairman, Jeff Clarke, our CFO, Tom Sweet and our Treasurer, Tyler Johnson.

During this call, we will reference non-GAAP financial measures, including non-GAAP revenue, gross margin, operating expenses, operating income, net income, EPS, EBITDA, adjusted EBITDA and adjusted free cash flow. A reconciliation of these measures to their most directly comparable GAAP measures can be found in our web deck and press release.

Please also note that all growth percentages refer to year-over-year change, unless otherwise specified.

Finally, I'd like to remind you that all statements made during this call that relate to future results and events are forward-looking statements, based on 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. We assume no obligation to update our forward-looking statements.

Now, I'll turn it over to Jeff.

Jeff Clarke Thanks Rob.

Good afternoon, everyone.

I would like to cover three topics before Tom goes through the financial results. First, our view on the IT spending environment. Second, new solutions we have introduced. And third, the current demand backdrop.

We are in the midst of a technology-led investment cycle that is accelerating digital transformation. The latest IDC forecast for IT spending through 2022, excluding telecom, supports this view with projected growth to be more than 2x real GDP. That investment is fueled by exponential increase in data and data-centric workloads that are driving better business outcomes, alongside an increasingly diverse and mobile workforce.

Our investments in solutions and innovations are pointed directly at this opportunity. We have a differentiated portfolio that is delivering solutions from the edge, to the core, to the cloud and our customers are taking advantage of the value that Dell Technologies provides.

This was all clear earlier this month when we hosted 15,000 customers, partners and industry experts at Dell Technologies World.

At this event, we unveiled the Dell Technologies Cloud, a new set of cloud infrastructure solutions to make hybrid cloud environments simpler to deploy and manage as customers continue to move towards hybrid cloud environments.

We announced a new Data Center-as-a-Service offering. This fully managed solution brings the simplicity of public cloud service consumption to an on-premise environment. This service can be combined with Dell Technologies Cloud Platforms or public cloud on Dell Technologies solutions like VMC on AWS to create a singular and seamless management experience across the edge, core, and cloud environments.

In addition, Michael, Satya Nadella and Pat Gelsinger announced an expanded partnership with Microsoft to enable our customers to extend their on-premise VMware cloud environments to Azure.

And earlier in the quarter, we announced the industry's first jointly engineered hybrid cloud infrastructure stack that brings together VxRail and VMware Cloud Foundation to facilitate compute, storage and network virtualization, delivering the fastest ramp to the Dell Technologies Cloud.

All of these solutions represent breakthroughs in cloud innovation that enables a flexible range of IT and management options with tight integration and a single vendor experience for purchasing, deployment, services and financing. They provide customers an operational hub for their hybrid cloud, on premise, with consistent cloud infrastructure across all cloud types.

To advance customers' workforce transformation, we announced Dell Technologies Unified Workspace that helps our customers fundamentally change the way they deploy, secure, manage and support their devices.

Unified Workspace provides a full PC lifecycle experience and provisioning strategy, all powered by the cloud, by integrating VMware Workspace One, which enables customers to access any application on any device, any time; SecureWorks threat intelligence and detection to prevent, and detect, and respond to potential security issues; and Dell

Provisioning and Deployment Services on our award-winning Commercial PCs.

These examples best demonstrate how Dell Technologies is innovating and collaborating across the physical and virtual infrastructure, cloud, PCs, security and services to deliver highly integrated solutions for our customers. And we are just getting started as we build on our leading positions in software-defined data center, enterprise hardware, security and PCs.

Shifting gears to the current demand environment, our external storage business is healthy, delivering solid year over year orders growth. Our sales teams remain optimistic about our portfolio and positioning as we head into Q2 and beyond.

In addition, software-defined data center solutions and HCI continue to grow at a healthy clip, with VxRail growing triple digits again in Q1.

Turning to servers, the industry saw unprecedented growth last year. We planned for slower growth this year but the Q1 demand environment was softer than we and the industry expected.

We were consciously more selective on some larger server deals during the quarter, particularly in China, and we focused on acquiring new customers and balancing top line and bottom line results across the entire server business. The result, a decline in revenue but with higher profitability.

We have built a business to be successful in any environment. Whether the market expands or contracts, we expect to outperform the industry. And when IDC releases calendar Q1 share data later in Q2, we anticipate gaining share again in servers.

You should expect us to continue to balance growth and profitability. We did that in Q1 and you should expect us to focus on balance in Q2.

Switching to our client business, we are seeing continued strength in the Commercial PCs, driven in part by increased coverage in small and medium business and the Windows 10 refresh. In a growing market, we gained 220 basis points of share according to IDC in calendar Q1.

We gained worldwide PC share for the 25th consecutive quarter, according to IDC, with share up 80 basis points.

Longer-term, we remain optimistic about IT spending as organizations continue to invest in software-defined data center, as well as IT infrastructure to support their edge and cloud strategies. And no one is better positioned than Dell Technologies to help our customers with these needs.

With that I'd like to turn it over to Tom to talk about the Q1 results.

Tom Sweet

Thanks, Jeff.

Our model is focused on long-term profitable growth, with the ability to adjust as needed based on market conditions. We are focused on growing faster than the industry and our competitors; growing operating income and EPS faster than revenue; and generating strong cash flow over time.

We executed against these strategic focus areas in Q1 as we balanced revenue and profitability with market conditions.

Revenue was $22.0 billion, up 2 percent and our deferred revenue balance increased to $24.2 billion, up 15 percent. FX was a headwind this quarter, impacting year over year growth rates by approximately 280 basis points.

Gross margin was up 7 percent to $7.4 billion, and was 33.8 percent of revenue, up 170 basis points, driven by lower component costs and balanced pricing in both servers and PCs.

Operating expenses were $5.2 billion, up 7 percent, primarily due to investments we have made in our sales coverage and were 23.8 percent of revenue. Operating expenses were down sequentially, consistent with comments on our year-end call.

As a reminder, we discussed our expectation that our investments in sales capacity and coverage would add operating expense, and that we expect to begin to see the benefit of these investments ramp as we move into the second half of the year.

Operating income was up 8 percent to $2.2 billion, or 10.0 percent of revenue.

Our EPS of $1.45 benefitted from strong operating results but also from a lower tax rate in the quarter.

Adjusted EBITDA was $2.6 billion, or 11.7 percent of revenue, and $10.5 billion on a trailing twelve month basis.

Although Q1 tends to be our lowest cash flow quarter due to revenue seasonality and timing of annual bonus payouts, we generated cash flow from operations of $682 million. Adjusted free cash flow was $116 million.

We repaid approximately $400 million of gross debt in the quarter and we have now paid down $15 billion of gross debt since the EMC merger. We remain on track to repay approximately $4.8 billion of gross debt this year.

Shifting to our business unit results, ISG revenue was $8.2 billion, down 5 percent.

While storage order growth was solid, as Jeff mentioned, storage revenue was down 1 percent to $4.0 billion, as we built backlog given the timing of when storage orders were received.

Servers and networking revenue was $4.2 billion, down 9 percent. Recall that we grew 41 percent in Q1 of last year. We did plan for slower server growth coming into this year, but we did see slower server growth than we anticipated. This was more pronounced in a few areas, principally China and in certain large Enterprise opportunities. We have discussed in the past that we are continuing to focus on expanding the server customer base and we balanced revenue growth and profitability as went through the quarter.

ISG operating income was $843 million or 10.3 percent of revenue. Operating margin percentage was down 50 basis points due to investments in sales coverage, which offset higher gross margins.

Our VMware business unit revenue was $2.3 billion, up 13 percent. Operating income was $614 million, or 26.9 percent of revenue.

Based on VMware's standalone results reported earlier today, the company generated license bookings growth in all product categories, with NSX up over 40 percent and vSAN up over 50 percent year over year.

CSG revenue was $10.9 billion, up 6 percent. Within CSG, Commercial revenue was $8.3 billion, up 13 percent driven by double-digit growth in Commercial notebooks, desktops and workstations. Consumer revenue was $2.6 billion, down 10 percent as we prioritized Commercial mix and the higher end of Consumer PCs.

We saw better profitability in CSG this quarter due to component cost declines, commercial/consumer mix and pricing discipline. CSG Operating Income was $793 million or 7.3 percent of revenue. Going forward, we continue to balance revenue and profitability against market dynamics.

Dell Financial Services originations were $1.7 billion, up 2 percent.

Turning to our balance sheet and capital structure, we ended the quarter with a cash and investments balance of approximately $9.8 billion.

During Q1, we refinanced approximately $6 billion of debt, freeing up fiscal year 20 cash flow to repay longer dated debt and reduce our larger maturity towers coming due in 2021 and 2023.

Our core debt balance ended the quarter at $38.6 billion. Net core debt, which is core debt less cash and investments excluding unrestricted subsidiaries, ended Q1 at $33.2 billion. Please see slide 13 in our web deck for more detail.

We remain committed to maximizing free cash flow, reducing leverage and achieving investment grade ratings.

As we head into Q2, we continue to monitor the macroeconomic environment, the IT spending environment and ongoing trade discussions between the US and China.

With the help of our supply chain team, we have navigated the first three China tariff lists and are well-positioned against the announced tariff increase from 10 percent to 25 percent. We have been planning for a potential fourth list which could impact notebooks and monitors. There is not a firm target date in place, but we will adjust our global supply chain as needed to minimize the impact to our customers.

We do expect component costs to continue to decline through at least the next two quarters, though at a lower rate than we saw in Q1. Our direct model and associated lower inventory position provides flexibility relative to our competitors. We will continue to be disciplined on pricing as we move through the year but we will also ensure that we adjust as appropriate given market and competitive dynamics.

Moving to guidance, based on Q1 results and our current expectations for the balance of the year, we are trending toward the midpoint of the GAAP and non-GAAP revenue ranges for the year, and above the midpoint of our GAAP and non-GAAP operating income ranges.

We now expect our GAAP EPS outlook to be better than the high-end of the range, primarily due to discrete tax and other items.

We expect our non-GAAP EPS to be above the midpoint of the range for the full year after taking into consideration the EPS adjustment we announced in March for refinancing activity.

In closing, we are well-positioned with one of the strongest portfolios in the industry. We are focused on long-term value creation and we believe that there is no better partner than Dell Technologies to help our customers realize their digital future.

With that, I'll turn it back to Rob to begin Q&A.

Robert Williams Thanks, Tom.

Let’s get to Q&A.

We ask that each participant ask one question to allow us to get to as many of you as possible. Ian, can you please introduce the first participant?

Operator: We'll take our first question from the line of Wamsi Mohan from Bank of America Merrill Lynch.

Wamsi Mohan: Yes, thank you so much. Could you just elaborate on the server weakness? Maybe just give us some color on server units versus ASPs? And I appreciate the comment on de-risking the business model more broadly from any upcoming tariffs. Could you give us some color on what specifically Dell is doing to actually circumvent that and be well prepared in the event that those do transpire? Thank you.

Tom Sweet: As we talk about the server market that we saw as well as the tariff framework and what we're doing about it, I would remind everybody that as we went through Q1, we did see IDC drop their mainstream revenue forecast for the market for calendar '19 I think from 3.4% to approximately 1%. As we thought about the year this year, we also had expected a slower server market.

If you think about the velocity in the business last year, I think server and networking overall was up 28% last year in Fiscal '19, and Q1 last year was up 41%. I think what we saw was a softer than anticipated growth even off the lower planning assumption.

Our philosophy in this environment, and remember what we continue to talk about is that we want to run the business for the long term, we want to grow relative to the market and take share, but that growth needs to be profitable and it needs to drive cash. That was the framework we were working our way through as we work through the quarter.

As we think of what we saw, a couple of thoughts I'll provide for you; one was we did see softness in China. If you guys recall our Q4 conversation, we had talked about the fact that we were going to be adjusting our China model given some of the dynamics we saw in China and that played out as anticipated.

And then, secondly, we also saw particularly in the large enterprise space, a handful of deals that, quite frankly, as we were looking at them, the profitability profile just didn't make sense to us, so we didn't participate in that. And so we balanced as we made our way through the quarter both from a revenue profitability perspective and I think we're pretty disciplined in how we did it.

And, look, given where the market was and given what we saw, I feel pretty good about how we navigated the quarter there. Again, there is demand out there if you want to take it, but sometimes the profitability framework doesn't make sense. I think that was the balance that we drove there. I don't know, Jeff, if you'd add anything to that?

Jeff Clarke A couple of points. Specifically, Wamsi asked about ASPs. ASPs on a year-over-year basis on our server business were up. I look at our high-value workloads, the portion of the high end of the business that we have. It continues to grow.

I remind everybody, I think we said it in our comments, we took share. We believe when IDC reports its share data later in Q2 on the Q1 calendar that we will have gained share again in the server business. And I think the backdrop that Tom painted where there was a slowing in demand is correct in the soft spots that he mentioned around China and large enterprise is very much spot on.

We still think there is a long-term outlook that is very positive for servers and we're going to focus on a relative share position adjusting to the market conditions. We're going to continue to grow our customer base, which we did in Q1, and we'll continue to drive the business and look after cash flow as we manage that business on a quarter-by-quarter basis.

Robert Williams We're going to skip that second question, Wamsi, and we can come back to it at the end if we have time. Let's move to the next question.

Operator Our next question is from the line of Shannon Cross from Cross Research.

Shannon Cross Thank you very much. If we could talk a bit about the strength you saw in the client margin, how sustainable that is, and maybe if you can just talk overall sort of how you did in server, about what you're seeing in terms of client in general. Thank you.

Tom Sweet Hi, Shannon, it's Tom. I think as we look at the client business for the quarter, I think a couple of thoughts I'd provide to you. We said in Q4 as we did our Q4 call a few months ago that the client pricing environment was relatively benign. I would tell you that that continued on into Q1, principally given some of the industry chip dynamics that we continue to navigate through.

Clearly, as we ran the business this quarter, we mixed towards the commercial business that generally pulls a higher profitability profile, if you will. Obviously, we had some benefit of the component cost deflation that we saw during the quarter.

As we think about the business, there are a couple of things we're still working our way through the navigation as we walk into the coming quarters. How do we think about the slowing component cost framework relative to what we saw in Q1 and then our pricing actions as a result of that?

There's some uncertainty around the mix of the dynamics of the industry chip shortage that we're going to have to continue to work through. We'll manage our operating margin appropriately.

From a demand perspective, we were clearly pleased with what we saw in the quarter. I think we benefited from the sales coverage expansion that we've done over the last year, year and a half. We also are, obviously, benefiting from the Win10 refresh cycle that continues. I think we remain optimistic about the client business for the year and we'll manage it appropriately given some of the dynamics and uncertainties that I think we'll see as we work our way through the year.

I don't know, Jeff, if you would add anything to that.

Jeff Clarke: I'd add a couple of comments. The mix I think is important. When we look at the mix of commercial and high-end consumer, we've certainly benefited from that. And we saw our direct business grow at a premium to the marketplace, which as you know carries the attach of S&P services and financing, which are margin accretive to us. And we're in a world of favorable dynamics in Q1, no question.

I do think as we look at the remaining part of the year, and Tom touched upon this, we have what will became a more consumer second half because we have a consumer mix shift in the second half. We have the possibility of a list four and tariffs that we'll have to navigate as we go forward. And we certainly have, as Tom mentioned, the ongoing challenges of managing demand and supply based on part availability.

So, that's kind of how we look at the year, reinforcing what Tom said and a couple of other points to think about.

Robert Williams: And our next question is from the line of Toni Sacconaghi from Bernstein.

Toni Sacconaghi: Yes, thank you. I just wanted to follow up on servers. I was wondering if you could comment around linearity through the quarter. Did you actually feel like the demand environment got progressively worse over the course of the quarter? Part of the reason I ask that is you said that storage was very back-end loaded, which would suggest that demand didn't really get worse for storage. Maybe you can contrast why you think enterprise demand in servers was weakening and not in storage and whether there were different linearity patterns that you saw in storage versus servers.

And then what are you modeling going forward for servers? Do you actually think the demand environment comes back or do you think it continues to soften? What is baked into your expectations for Q2 and your reaffirmation of revenue guidance for the year?

Tom Sweet: Toni, it's Tom. From a linearity perspective within the quarter, I would offer this as it relates to server. Early in the quarter, we saw softness in the server demand velocity, if you will. And that softness lasted maybe the first half of the quarter to something of that effect.

We took some pricing actions along the way to ensure that we were in the right price position across the globe and we did see demand on server begin to pick up as we moved through the latter part of the quarter.

I do think that we'll have to continue to watch it in the sense of some of the weaknesses that we called out. I think China continues to be a headwind given the dynamics that we're seeing over there.

I will tell you, outside of those couple of soft spots that we called out, in general, we saw reasonable server demand in some of the other areas of the globe. We're not in the business of forecasting the market growth for servers, and I'll point back to we do think that according to IDC, the server market has softened. And we're going to navigate our way through that. And part of the reaffirmation of the guidance or the midrange, midpoint of the guidance, if you will, on revenue, was around -- if you look at the broad capabilities and solution sets that we had with the business to the extent I have softness in certain areas, I also have strength in other areas.

And so we're balancing our portfolio, managing the business I think in the framework that I previously articulated as we move through the year.

Toni asked also the question relative to storage. I do think that from a linearity standpoint, storage does tend to be more back-end loaded fairly consistently.

Jeff Clarke — No, it is. To emphasize what Tom said, look, we saw the business decelerate through, as Tom said, the first portion of the quarter and we saw a rebound. We took some pricing actions along the way. We saw the businesses that would respond to list price actions respond appropriately. We think there's certainly inventory that's being digested in the ecosystem as a whole.

Clearly, last year there was a very high growth for servers, and I think we're seeing some of that being digested through the year. We saw some customers waiting for Cascade Lake, and now that we have Cascade Lake shipping, we're seeing a nice ramp to the new microprocessor technology. I think that's encouraging.

And then, again, you saw our storage business and what Tom mentioned as they build up toward the end of the quarter, which is historically what we see in our largest accounts, and we saw a nice steady state through our commercial business of our storage demand. And VxRail continues to do well as a hyper-converged, software-defined storage offering in the marketplace.

Robert Williams — Thanks, Jeff. Thanks, Toni. Ian, do you want to go to the next question?

Operator Certainly, our next question is from the line of John Roy with UBS.

John Roy Great. Staying on the storage theme, can you give us some color on the midrange? Are you seeing people waiting for your new product refresh? And we were expecting you to do a little bit better on storage. Can you give us any more color on the competitive environment within storage?

Jeff Clarke Sure, I'll start, John. This is Jeff, and I'm sure Tom will layer in as well.

We tend to look at the storage market opportunity through the price band. And when I look at our price band performance across our portfolio, I'm quite pleased on an orders basis. I mentioned orders had healthy growth for the year. We grew on the high end, the high-priced bands, the mid-range price bands, and the entry-level price bands across our variety of products, whether that's the PowerMax product, our Isilon unstructured product, or our Unity product, and we're pleased with that velocity, if you will, of our core storage array business.

I don't look at it as a midrange product or category because, again, it's price bands. We sell the PowerMax 2000, as an example, at what some would call midrange price bands. Unstructured products are sold in mid-range price bands. So, we tend to look at our performance across all of the portfolio. And as I said, the orders basis was a healthy growth for us.

Tom Sweet And I would add, John, in the remarks that I made that, look, we did build backlog in storage, given given some of the hub storage path order...

Jeff Clarke Order of linearity.

Tom Sweet Because of the linearity of the storage orders that came in. Look, I think we feel good about the solid order demand we saw in the storage and we'll continue to press on.

I think we talked a lot about the fact that Jeff and his team have refreshed the product line. We've got new storage capability coming out towards the end of the year, so we feel good about the position of the overall solution sets that we're offering.

Jeff Clarke The capacity and coverage that we've put in place is coming online, it's coming up the productivity curve, we're encouraged by that. The product line continues to get stronger. Where we were a year ago versus today is literally night and day.

At Dell Technologies World, we announced extensions of Unity with the Unity XC, which is a huge performance boost and it's very competitive in this midrange price bands.

I look at what we did with storage-class memory, the first to make in our high-end storage arrays. And then, certainly, you know, we've talked consistently about the next generation midrange product towards the end of the year, and that remains on target.

Robert Williams Thanks, John.

Operator Our next question is from the line of David Eller with Wells Fargo.

David Eller Good afternoon. My main question was on free cash flow when you exclude VMware and the DFS business, was negative $1.1 billion, kind of one of your toughest performances in some time. Can you talk about the drivers of that drag in the quarter?

And then just looking for some additional color on some of the prior questions. You talked about servers in China and with large enterprises. Can you just talk about China more holistically, the IT spending environment overall? And then from the large enterprises, what were you hearing there from large enterprises? Is it a sense of more caution related to the tariff and trade war? Any color would be helpful, thanks.

Tyler Johnson David, this is Tyler. Maybe I'll jump in here and talk about the cash flow. So, yeah, I mean, typically Q1 is our weaker cash quarter. I would tell you that this was pretty much in line with expectations, and that's partly why I felt comfortable paying down the $400 million, which quite frankly was not something I really planned on doing when we started the quarter.

If you look at the comparison relative to last year, for example, really, one of the bigger drivers is that we had a pretty large compensation payout this quarter, which was driven by the bonus.

As I look forward and I look at where I am today and I think of my expectations for the rest of the year, Tom said during the talking points that I feel good about us paying down the $4.8 billion so we're on track.

I'm happy, but if you think forward, by the end of the year and you look at how our debt maturity towers are going to look, it's going to look much different than where we started before we did the refinancing. I feel good about where we're going. Everything is on track.

Tom Sweet As it relates to the second part of that question, which is around China and what we're seeing in China, look, yeah, I would tell you that, obviously, it's an important market for us. It's our second largest market. I think we in the set a high single -- in terms of the revenue mix in terms of the whole, it's high single digits.

We obviously have, we think, a good relationship and a good business there. Clearly, the U.S./China trade tensions are a bit of an overhang on the business.

We did see more competitiveness in the market, and principally in the server space there this quarter than a year ago where part of that is, I think, the component cost framework year over year and what we saw were some of the opportunities there and the pricing around those just didn't make sense from a profit framework that we were driving or trying to execute to.

We also had talked about in the past, relative to the which business on servers, that we wanted to diversity that buyer base, and we've been working on doing that.

So, I think we've balanced the business with what we saw in the market and what we thought made appropriate sense.

Absent servers, though, I mean, we're pleased with the commercial client growth there. We're pleased with the storage growth in China. Again, it's just one of those things where we'll have to continue to watch that business as we move forward through the year and adjust as appropriate, given what we're seeing in the market and the broader macro dynamics.

Robert Williams: Thank you, David.

Operator: Our next question is from the line of Steve Milunovich from Wolfe Research.

Steve Milanovich: Thank you. Could you explain your cloud strategy and the impact that you expect on the company? You've got VxRail integrated with VCF, you've got the Dell Cloud Platform. You've now got the Azure relationship, but Pat's kind of gone out of his way to say, hey, our number-one partnership is with AWS. Could you kind of talk about what the strategy is? And then are we going to see most of the benefit of that in VMware or on the Dell side as well?

Jeff Clarke: Sure, I'll be happy to talk about the strategy, Steve. Look, we made a big series of announcements at Dell Technology World a handful of weeks ago and we talked about the Dell Technologies Cloud.

And we specifically talked about where you could build your own cloud platform based on our HCI and CI stacks with VMware's Cloud Foundation. For those organizations that want to deploy their own on-prem cloud, hybrid cloud, and have the consistency of management and automation, we provide the tools of high levels of integration to do that with our VxRail and our VCF product -- or I should say VMware's VCF product. And I think that is very much a differentiated offer.

Well, you'll see us continue to build around that. We will add more capability. We talked about extensions of that platform into our primary storage arrays, and you'll continue to see us to be able -- or to enable our customers to build edge-deployed core data center deployments around that.

And the other offer that we announced was our data center as a service. So, basically, the ability to have a public cloud experience on prem. So, your own private cloud delivered as a service in your own private data center on the edge of your network, fully managed by us, offered as a subscription by us. It's built on VxRail and VMware Cloud Foundation. We install it, we manage it, and just like any other cloud service that a customer is consuming today.

And then we also extended our cloud strategy with the announcement we made with Microsoft that essentially we allow customers who want to use public cloud and public cloud services, VMware software-defined data center running in the cloud, including AWS, which is already in the marketplace today, and then what we announced at Dell Technologies World, VMware services for Azure.

We're pretty excited about that. We believe that gives customers a wide range of capabilities in this multi-cloud world. We see customers today deploying on average five different cloud architectures today. They want consistency in management and automation and how to deploy and how to provision. What we announced and what our strategy is allows VMs and applications and containers to move from the edge to the core data center to the public cloud, all orchestrated by us, specifically the VMware capability, and then building highly integrated infrastructure products in that to help our customers.

That's the strategy that we spent the vast part of Monday and Tuesday on at Dell Technology World talking about. Does that help?

Steve Milanovich — As well as VMware?

Jeff Clarke — I sorry, I didn't hear that last part of the question.

Steve Milanovich — It sounds like Dell hardware should benefit from this as well as VMware.

Jeff Clarke — Well, the answer is it is a highly integrated solution. Certainly, when you look at the managed service, it's actually a Dell Technologies managed service, which as VMware components and Dell EMC infrastructure components. And if you think about the build-your-own or build it as a platform, clearly, we will benefit from the Cloud Foundation product.

Tom Sweet — So, you would expect to see the benefit showing up both at the Dell level, Dell EMC level, as well as at a VMware level. Now, obviously, some of that will depend on the mix of what that solution set is that's being purchased.

Jeff Clarke — And the extensions of services that we couple around that we'll be able to have a broad and rich set of capabilities around both the on-prem or the managed service, the built on-prem or managed on-prem versions.

Robert Williams — Good. Thanks, Steve.

Operator — And our next question is from the line of Katy Huberty with Morgan Stanley.

Katy Huberty — Yes, thank you. Gross margin was up sequentially, despite the mix shift towards low-margin PCs, away from some of the higher-margin businesses, which speaks to your ability to capture the volatility in commodity prices better than your competitor.

I guess my question is: How much longer would you expect to benefit from particularly lower memory prices and as some of your high-margin segments come back seasonally, could we see gross margins above the level you posted in the first quarter in 2Q and 3Q? Thank you.

Tom Sweet — Katy, it's Tom. One, I thank you for recognizing that we do have a broad portfolio and we pivoted and managed the business appropriately given the dynamics we saw in the market, or at least in our opinion we did.

As it relates to margin, we do think that component costs -- we do see deflation happening in the component cost environment over the next couple of quarters, as we highlighted in our talking points.

We also think about the fact that the commercial client business will continue, in our opinion, to benefit from the Win10 refresh cycle that's going on. And given the chip shortage, we'll have to navigate through that.

So, in terms of do we get a margin expansion out of that? I would point you back to as I provided in some guidance comments in part of my talking points that we do expect now to be trending towards the above the midrange on operating income and non-GAAP EPS.

So, I think that's how I would anchor you on that. We'll continue to manage it. The unknowns here, Katy, are around the impact of trade and tariffs if that were to come to fruition and how would that potentially have an impact on demand? I think we feel good about the work that the supply chain team has done in terms of mitigating or potentially mitigating the impacts of list four, but that is a bit of an unknown.

And then we'll have to see how the pricing environment behaves as we move through the year. And so, again, we try to give you some perspective, but I would, again, point you towards look at the operating income framework that we laid out for you as part of the call.

Robert Williams — Thanks, Katy. Let's go to the next question.

Operator — And our next question is from the line of Rod Hall with Goldman Sachs.

Rod Hall — Yeah, hey, guys, thanks for the question. I guess I wanted to clarify the timing of the change in demand that you've seen, because the tariff stuff, the trade stuff blew up in late April. And, yet, it sounds like what you're saying in response to some of the prior questions on linearity is that you saw demand earlier in the quarter. And then you made pricing changes, and then that seemed to cause demand to perk up late in the quarter. It almost sounds like demand was weak prior to some of the trade news that went the wrong way. I just wonder if you could comment on what you think was going on there early in the quarter when demand was weakening. Do you think macro was a little bit here before this all came up or do you think people were anticipating a negative trade outcome?

Tom Sweet

Hey, Rod, it's Tom. Let me frame this a little differently for you. We're talking about a couple of trends here that we saw in the year. I would tell you that our commercial client business was strong throughout the quarter. So, that was relatively strong through the quarter. And so the trade conversation, if you will, wasn't an influencer from what we can tell.

The server conversation we had, which is what we said was soft in the first half of the quarter and picked up in the second half, I think you need to separate that a little bit from the trade and tariff conversation, right? What we saw there was a relatively soft February and first half of March in servers. We made a series of list price moves to try and ensure that we were in the appropriate price position in early to mid-March, and we began to see better velocity in the what I would call the transactional run rate server business as we worked our way through the quarter.

I do think we saw -- we did see, as we said in China and in some large enterprise, some very competitive pricing or some pricing on some of these large deals that didn't make sense to us. Again, I think you've got to separate that from the trade and tariff conversation.

So, what we're trying to articulate, and maybe not doing a great job on, is to say that the server market clearly was softer than what we expected it to be. You know, and so we spent the quarter on server sort of managing the balance of where do you push on revenue, where do you not push on revenue? Because the margin framework just didn't make sense.

And, you know, at the end of the day, we opted towards, hey, a little less revenue and the profitability framework that we delivered. So, that's how the quarter set up. And then storage velocity, which typically has a more back-ended linearity, sort of followed that same linearity through the quarter.

So, you know, the overhang here, the macro dynamic around trade and tariffs is one we're watching just because you think about the impact on business confidence, consumer confidence, you think about the impact on our domestic China business, those are the dynamics that we're also keeping our eye on. Our domestic China business, the server impact there, we were soft in servers in the China business. Some of that by design as we stepped away from these large deals that didn't make sense to us from a profitability perspective, however, on the other hand, we saw reasonable demand growth and revenue growth in client and in storage in China.

So, China was a little bit -- the domestic business in China was a little bit of a mixed bag. So, hopefully that helps you frame this a little bit better as we thought about the dynamics that we managed our way through during the quarter.

Jeff Clarke: Tom, I would add, again, in our mind, the trade tariff conversation is very different and separated from the server velocity that we've been talking about. We started, and I think we mentioned it in our Q4 call about China servers and the slowing of our China server business. So, we saw that coming into the quarter. And, again, it's very separated from the tariff conversation that we've been having in and out of the conversation today.

That velocity or that lack of velocity we saw continue through the quarter in Q1 in China.

Robert Williams: Great, move to the next question.

Operator: And our next question is from the line of Jim Suva from Citigroup.

Jim Suva: Thanks very much. Keeping on the server commentary, you mentioned China a lot. Was the softness exclusive to China? And if so, would you expect it to percolate to other regions? And if not, why would it not or what's so unique about that market? Thank you.

Jeff Clarke: Jim, this is Jeff. I'll take a swing first, and then Tom can come in over the top. I think we've been trying to consistently deliver a message that the China velocity or lack thereof was primarily China, as you picked up, but secondly and equally important, is a large enterprise, a handful of deals that are opportunities if you prefer is where we saw the significant slowdown in our business.

I think Tom mentioned earlier, in the other parts of our server business, we had growth. But it was isolated to our China business and those handful of large enterprise opportunities where Tom mentioned those and the aggressive pricing in the marketplace for those opportunities was below our profit threshold.

Tom Sweet: Jim, it's Tom. I would just add that, look, again, we're going to manage this business in a way that makes sense. We obviously want to grow. We want to grow relative to the market. We believe we'll take share again when the results get posted next week in terms of the server overall marketplace. And we'll balance the revenue and profitability profile as we work our way through the market dynamics.

And so we saw a reasonable growth in other parts of the globe, and we'll continue to manage the business appropriately.

Jeff Clarke — I'd come back to relative share position, gain share. We grew our customer base, and we balanced, given the softer market, revenue and profit I think in a very solid way.

Robert Williams — Thanks, Jeff.

Operator — And our next question is from the line of Matt Cabral from Credit Suisse.

Matt Cabral — Thank you. Tom, you touched on this in response to an earlier question, but just wondering if you can talk specifically about the impact that tariffs had on margins in the quarter and just how to think about what you factored into the full year for the new 25-percent rate and any potential actions on the outstanding goods not currently covered.

Tom Sweet — Thanks, Matt. So, from what we saw, we don't believe tariffs had a substantial impact or significant impact on what margins we saw in the quarter.

Jeff Clarke — No. We've successfully mitigated the first three lists.

Tom Sweet — We mitigated the first three lists. If we, in fact, get raise in tariffs from 10-25%, we think the mitigation strategy that we put in place will continue to sustain the offset or mitigate the impact of the tariffs.

If we think about list four, we have strategies in place, given our global supply chain and our flexible supply chain. We have over 25 manufacturing facilities around the globe that we believe will be able to mitigate the substantial majority of that impact.

So, if we couple that with the guidance framework and ranges that we provided, we feel comfortable that we'll be able to navigate our way through the tariff conversation, absent the one comment I made earlier, which is I do think if you were to see these tariffs enacted, we'll have to see what the overall effect is on consumer and business confidence relative to the demand environment. That's the one thing that's a little hard to model right now. But in terms of our cost base and what we should be able to do, I think we'll be able to mitigate the vast majority of the impact.

Robert Williams — Thanks, Matt. Ian, I think we've got time for one more question.

Operator — Very well. Our final question comes from the line of Simon Leopold from Raymond James.

Simon Leopold — Well, thank you. I wanted to maybe see if we could step back on macro apart from what's going on on tariffs. What I'm struggling with is a number of your peers and competitors selling into the IT space have cited various company-specific reasons for weaker sales and execution. But it seems as if we net it all out that -- and I'm trying to stay apart from the tariff issues, we are seeing some softening in enterprise demand in

Europe and the U.S. And I'm wondering if you could maybe give your perspective for how you may be seeing this differently or what you're seeing in terms of these macro changes. Thank you.

Tom Sweet: Look, I mean, if you just step back and think about what we see macro, there's clearly dynamics in the macro environment, right? Besides the trade and tariff conversation we've been having, you've got a Brexit overhang, you've got political dynamics going on.

But step back and think about the underlying IT technology investment trends, right? That there is an investment cycle happening. And if you believe the IDC framework is 2X GDP over the next number of years, and if you looked at the IDC forecast, you would see that the IDC technology investment cycle as they calendarized it by year, actually, the technology spend IDC forecasted to dip slightly this year, which is essentially what we're seeing is a little bit of softening in the environment. I think that's undeniable.

What we're trying to covey is as we manage the business and the broad set of capabilities and solutions that we have, we're pulling various levers as we go through the quarter around managing for both growth where we think growth is there to get, that makes sense. That generates profitable growth, that generates cash, versus do I go push on growth and go buy revenue with no margin or negative margin? Which you can do in some of these areas.

So, what you're hearing us articulate is we grew on a non-GAAP basis revenue 2%, we built deferred revenue balances, we had a very strong client quarter, storage demand was good. Yes, there was softness in the server environment, that's just something we'll have to continue to navigate through, principally contained in China and in some of those large enterprise -- handful of large enterprise opportunities.

And so I think our job as the leadership team and the management team is to execute our way through those dynamics. And that's what we'll continue to do as we move into Q2.

Look, we'll have to see how the year unfolds. You've obviously heard that we still like the framework that we laid out at the beginning of the year. We pointed you toward the midpoint of revenue, of that revenue range from a revenue framework perspective to think about, and we pointed you above the midpoint of the operating income in EPS. Obviously, we'll keep our eye on this and adjust as appropriate as we go through the year.

But we remain optimistic about the opportunities that we have and our positioning in the market.

Robert Williams: I appreciate it. Thanks, Tom. Thanks, Simon. We'll have an opportunity to revisit this as we get to the end of the second quarter and we announce results at the end of August. And then it's our current plan to have a short meeting up in New York in the September timeframe to talk more about strategy. So, we'll continue to update the street on our view not only on the company, but also the overall environment, the macro, and what we're seeing.

With that, we'll wrap it up. I want to let you know that we'll be at the Bank of America Merrill Lynch Global Technology Conference in San Francisco on June the 5th. We'll be at Barclays High Yield Loan and Bond Conference on June the 6th in Colorado Springs. And we'll also be up in Toronto the following week on June 11th, and this will be members of the Investor Relations and Treasury team. We look forward to continuing the dialogue with everyone. Thanks for joining us.

Operator: This concludes today's conference call, we appreciate your participation. You may now disconnect at this time.

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