

DELL INCORPORATED

Moderator: Robert Williams
June 8, 2017
7:00 a.m. Central

Robert Williams Thanks Regina.

Good morning and thanks for joining us. With me today is our Chief Financial Officer, Tom Sweet; our President of Infrastructure Solutions Group, David Goulden; and our Treasurer, Tyler Johnson.

We've posted our first quarter press release and web deck on our website, where this call is also being webcast. Q1 financial results will be filed on form 10-Q tomorrow, June 9th. I encourage you to review these documents for additional perspective.

Consistent with prior periods, our Q1 non-GAAP operating income excludes approximately \$2.7 billion of adjustments. The majority of these are non-cash and relate to purchase accounting and amortization of intangible assets. Please note that due to the EMC merger and to a lesser extent the Dell go-private transaction, there will continue to be significant bridging items between our GAAP and non-GAAP results for the next few years, although the impact will decline in each subsequent quarter. Please refer to the web deck as well as our SEC filings for more details on our total non-GAAP adjustments.

As a reminder, please note that our First Quarter Fiscal Year 2017 historical results do not include EMC and unless otherwise specified, all growth percentages refer to fiscal year-over-year change, which may not be comparable due to the EMC merger.

During this call, we will generally refer to non-GAAP financial measures, including non-GAAP revenue, gross margin, operating expenses, operating income, net income, EBITDA and adjusted EBITDA on a continuing operations basis. A reconciliation of these measures to its most directly comparable GAAP measure can be found on Form 10-Q and in the supplemental material in our web deck.

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 the cautionary statement section in our web deck. We assume no obligation to update our forward-looking statements.

Now, I'll turn it over to Tom.

Tom Sweet

Thanks, Rob.

We were pleased with the overall results given some of the dynamics we worked through during the quarter. We completed our first quarter under the fully integrated annual plan and the new go-to-market structure. We aligned the family of businesses to the Dell Technologies' fiscal year calendar, and faced component cost headwinds in certain areas. We feel good about the velocity we saw in many areas of the business, the work we've done on integration, our cash and balance sheet management, and the success that we're seeing in our Dell Financial Services or DFS business.

While we made progress, there is still more work to do and we will discuss this in more detail later in the call.

Now jumping into the Q1 results.

GAAP revenue was \$17.8 billion with a GAAP operating loss of \$1.5 billion.

Non-GAAP revenue was \$18.2 billion. While year-over-year compares for ISG and VMware segments are not meaningful, CSG revenue grew 6 percent. On a standalone basis, last week VMware reported a growth rate of 9 percent.

Our ISG business saw revenue growth in PowerEdge Servers and strength in our newer solutions, including All-Flash arrays, hyper converged systems, and software-defined storage, with softness in traditional hybrid storage arrays. We are focused on improving overall storage velocity as we move forward and in balancing server revenue growth and profitability given the challenging component cost environment.

Gross margin at the consolidated level was \$5.6 billion or 31.1 percent of revenue and was impacted by pricing actions in both ISG and CSG as we navigated through component cost increases, as well as mix shifts within ISG. As a reminder, there are some instances where pricing commitments

are already in place and we can't always bridge that gap with pricing adjustments when the cost environment moves as quickly as we've seen it move recently. Going forward, we anticipate memory and SSD costs to be a headwind through the remainder of the year.

Opex was \$4.4 billion, or 24.5 percent of revenue. We continue to execute on our cost initiatives while also investing back in the business to drive growth in today's changing IT environment.

Operating income was \$1.2 billion or 6.6 percent of revenue.

Now, let me turn it over to Tyler, to provide additional commentary on adjusted EBITDA, cash flow, and capital structure.

Tyler Johnson

Thanks Tom.

Adjusted EBITDA for the quarter was \$1.6 billion dollars or 8.6 percent of non-GAAP revenue. Please see slide 17 in the web deck for more details on our EBITDA adjustments.

In Q1, we generated cash from operations of \$240 million dollars. Operating cash flow during the quarter was driven predominantly by profitability and working capital benefits. Cash flow was in-line with expectations and normal Q1 seasonality.

Our cash and investments balance was \$14.9 billion dollars, down approximately \$300 million dollars versus the prior quarter.

During Q1, we paid approximately \$100 million dollars in Term Loan amortization. In addition, as discussed on the Q4 earnings call, we closed on the re-pricing and upsizing of our Term Loan B, using the incremental \$500 million dollars to reduce our margin loan bridge from \$2.5 billion to \$2.0 billion dollars. Subsequently, we refinanced this Bridge into a \$2.0 billion dollar margin loan, now with a five-year maturity.

Since closing the EMC transaction, we have paid down \$7.1 billion dollars of gross debt, excluding Dell Financial Services-related debt, resulting in a \$200 million dollar reduction in annualized interest expense on a run-rate basis.

We ended the quarter with \$50.7 billion dollars in total principal debt, up \$400 million dollars due to the growth in our DFS business. Of this amount, \$41.9 billion dollars is core debt. The remainder included approximately \$5.2 billion dollars of debt that funds our DFS business, the \$2.0 billion dollar margin loan, and a \$1.5 billion dollar bridge facility, backed by VMware legacy intercompany notes due to EMC Corp.

Moving to our share repurchase program. To date, we have repurchased approximately 13.0 million shares of Class V Common Stock under the Class V Group Repurchase Program, totaling approximately \$800 million dollars. As a reminder, this portion of the repurchase program has been funded through a Share Purchase Agreement to sell VMware Class A Common stock to VMware. Since closing the EMC transaction, we've repurchased approximately 19.7 million shares of Class V Common Stock for a total of \$1.1 billion dollars when including the DHI Group Repurchase Program. We'll continue to evaluate repurchase opportunities in the context of our broader capital allocation strategy.

Before I turn the call over to David, I would like to highlight the portfolio growth momentum we are seeing in our DFS business. DFS is now the exclusive originator of the Dell EMC business and the preferred finance partner for VMware, which we expect to enable incremental revenue and profitability across our portfolio of solutions over time.

In Q1, DFS originations approached approximately \$1.1 billion dollars and financing receivables grew to approximately \$6.0 billion dollars, up 19 percent year over year. As the DFS business grows, so will our DFS-related debt, which includes both allocated corporate debt and structured financing.

I also wanted to comment briefly on the new consumption models we announced at Dell EMC World at the beginning of May. We are seeing growing customer interest in flexible consumption models as they work through their digital transformation. We expect the impact to cash to be immaterial.

To close, I want to reiterate what I said on the last earnings call and at the recent investor meeting. We remain committed to our conservative financial policy and overall capital allocation strategy. We continue to prioritize de-leveraging and optimizing the balance sheet through profitable growth and strong cash flow generation.

Let me turn it over to David.

David Goulden

Thanks Tyler.

Overall, the Infrastructure Solutions Group, or ISG, performed well in its first quarter with our new go-to-market structure as demand across the ISG portfolio grew mid-single-digits. While I was relatively pleased with the demand and overall revenue performance, we still have work to do to

improve our execution in some areas as we move forward. I'll provide more details on that in a moment.

At Dell EMC World in May, we announced major updates across our portfolio. These new solutions are designed to help our customers realize their IT and digital transformation goals, while letting them choose the pace and consumption model best suited for their organization.

In servers, we enhanced our position as the industry's leading vendor with our new 14G line that provides a more scalable business architecture, intelligent automation, and integrated security. This new generation of servers is the bedrock of the modern data center, creating a common platform that is essential in a server-centric, software-defined world.

In hyper-converged infrastructure, we announced several updates to our portfolio including a new VxRail 4.5 appliance, expanded capabilities for our XC Series and VxRack systems, as well as new flexible consumption models aimed at making hyper converged infrastructure easier and simpler to acquire, deploy and manage.

In storage, we announced a full line up of new all-flash storage solutions, including the new VMAX 950F, which is up to 4 times faster than our nearest competitor for mission critical workloads. XtremIO X2, with 3 times more capacity, 25 percent better storage efficiency, and 80 percent better response times than the prior generation. We also introduced new Unity, SC, and Isilon solutions to round out our midrange and unstructured all-flash portfolio.

In data protection, we introduced a new turnkey integrated data protection appliance which combines storage, protection, search & analytics in an easy-to-deploy solution. In networking, we introduced the industry's first 25GbE Open Networking switch for the software defined data center, designed to go hand-in-hand with our new 14G servers.

Additionally, we enhanced our software defined storage solutions with new ScaleIO and ECS updates. For a full list of product announcements from Dell EMC World, please visit our website.

Now turning back to results for the quarter, total Q1 revenue for the ISG business was approximately \$6.9 billion with operating income of \$323 million or 4.7 percent of revenue. There are a couple of factors to note regarding our operating margin performance.

First, consistent with historical trends, Q1 is typically the seasonally low point for the year and we expect operating margins to build through the year with volume.

Second, we had some gross margin headwinds including higher commodity costs and a mix shift between servers and storage.

Third, the quarter was impacted by a backlog build and some non-cash charges from the decision to discontinue certain products.

So, overall, while we were relatively pleased with our top line performance, we are laser focused on improving profit margins in Q2 and beyond.

Looking at results by segment, our server and networking revenue of \$3.2 billion, increased 5 percent. We remain the worldwide market leader in x86 server units, driven by our mainstream business where we gained 200 basis points of unit share and 260 basis points of revenue share, according to IDC.

We continued to see strength in our mainstream PowerEdge business with units and revenue up double-digits in the fiscal quarter while our high volume cloud business declined.

In storage, we generated revenue of \$3.7 billion.

To give you a sense of our performance, orders demand in fiscal Q1 was down mid-single digits, a similar rate to Q4. As a reminder, results from market research firms are based on calendar quarters and the change in our fiscal year caused our calendar Q1 results to be void of a typical month three as the quarter linearity shifted towards April.

While we were pleased with the performance of our high-end, all-flash, hyper converged infrastructure and software defined storage solutions we still have work to do in midrange storage. Our improvement in this space will start by taking advantage of the products we announced at Dell EMC World and by focusing our direct and channel teams on this market opportunity.

We also plan to extend our lead across all-flash storage with the broad range of product announcements I mentioned earlier. All-flash demand in the fiscal quarter grew very high double-digits as customers modernize their IT infrastructure with our market leading solutions.

Demand in our hyper-converged portfolio, including VxRail and XC appliances as well as VxRack Systems, continued to grow triple-digits driven by customer demand for fully integrated solutions. Additionally,

the early response from our new CloudFlex consumption model has been very positive with initial interest exceeding our expectations.

We drove strong performance against the rest of our cloud strategy this quarter as well. Demand for our Virtustream Public Cloud for mission critical applications grew approximately 100 percent. Later this year we will introduce a Virtustream Edition of our Enterprise Hybrid Cloud to encompass mission critical workloads on prem and with seamless connections to the Virtustream Public Cloud.

We also saw growth in our Native Hybrid Cloud solutions, which are powered by Pivotal Cloud Foundry, the world's most powerful developer platform, and used by organizations to rapidly develop and run modern and legacy applications at startup speeds.

In summary, I am extremely excited about our position in the market and our ability to help our customers with their most critical IT transformation needs. We had a solid start to the year in most parts of the ISG business with some work to do in midrange storage. Profitability will improve as we move through the year driven by volume, mix, and the removal of some of the factors that impacted Q1.

With that, let me turn it back over to Tom who will walk you through the Client Solutions Group.

Tom Sweet

Thanks David.

The client solutions business had a good quarter. According to IDC, the overall market was better than expected for calendar Q1. Worldwide PC unit shipments for calendar Q1 grew by 0.8 percent, exceeding IDC's forecast of a negative 1.8 percent. This was the first positive year-over-year growth quarter for the industry since calendar Q1 of 2012.

We gained share year-over-year for the 17th consecutive quarter, seeing positive unit growth in every region. According to IDC, Dell outperformed the worldwide market in both notebooks and desktops and in both commercial and consumer. We will continue to take share in this consolidating market, but we will do this while balancing growth and profitability.

Moving to Fiscal Q1 results, revenue for CSG was \$9.1 billion, up 6 percent. Both Commercial and Consumer saw growth in the quarter, up 3 percent and 12 percent, respectively, as we are seeing the benefits of improved go-to-market execution and investments that we've made in premium products and innovative form factors.

Operating income was \$374 million, down 3 percent on a tough compare, and was 4.1 percent of revenue. The decline was primarily due to increases in certain component costs that we were not able to fully offset through pricing actions within the quarter.

We saw strong momentum continue across both high-end consumer and commercial notebooks as XPS and Mobile Workstations each saw double-digit growth and Latitude saw high-single-digit growth.

In addition, we continue to focus on driving higher attach of services and accessories, which also drive higher margins to our client solutions. Specifically, we continued to see higher attach rates for our ProSupport offerings for commercial client and displays business also had another solid quarter of revenue growth.

We also mentioned during the Q4 call and the April Investor meeting that we were making investments back in the business in emerging growth areas. Specifically for the client business, these investments include gaming, high-end notebooks and displays. In addition, we are expanding our consumer and small business focus to 12 countries as we build on the momentum we've achieved from the five countries where this program was initially launched.

As Tyler and David have both mentioned, we are starting to see a change in how organizations address their IT needs, looking for new and more flexible consumption models to balance operating expenses and capital expenditures. In the client space, we introduced the Dell Technologies PC as a Service solution, which combines the latest Dell Technologies PC hardware, software and end-to-end services including deployment, management, security and support for a single, predictable price per seat per month.

We were generally pleased with the performance of CSG this quarter, especially given the component cost environment. Going forward, we are focused on driving velocity in our commercial client business and expanding our customer base through profitable share gains.

Now, shifting to the VMware segment and Other Businesses, VMware had another strong quarter. Revenue from the VMware segment was \$1.7 billion and operating income was \$486 million, or 28 percent of revenue.

We have started to see revenue synergies materialize as our integration activities continue and we see momentum across most of VMware's portfolio that continues, specifically, Emerging Technologies saw strong growth driven by vSAN and NSX.

Revenue from our Other Businesses, which includes SecureWorks, RSA, Pivotal, and Boomi, was \$462 million.

In the first quarter of FY18 Pivotal delivered strong top-line results, primarily driven by its subscription software products, Pivotal Cloud Foundry and Pivotal Data Suite. The team's momentum is being driven by new customer wins, increasing customer footprint, and an expanding partner ecosystem, including deeper engineering collaboration with cloud infrastructure players. For example, in March 2017, Pivotal was named Google Cloud Technology Partner of the Year.

As SecureWorks reported in their earnings release on Tuesday, standalone revenue was approximately \$114 million, up 14 percent, as this business continues to focus on growing monthly recurring revenue.

With the breadth of the Dell Technologies' portfolio, we are uniquely positioned to win in today's IT environment and meet our customers' needs in their transformation journey. We believe our position is getting even stronger with our recent product announcements made at Dell EMC World and our new flexible consumption models offered through Dell Financial Services.

In closing, we remain focused on executing our strategy and providing the right solutions for our customers as they move toward digital transformation. This was the first full quarter with the go-to-market changes and we made reasonable progress to date.

As a reminder, we discussed in previous calls that this transition could impact our results in the short term. We will continue to refine our sales coverage models as we move forward.

As outlined at the investor meeting in April, we're focused on several key themes for Fiscal '18. We want to strengthen our position as the essential infrastructure provider for our customers. We're a one-stop-shop that offers customers a single set of solutions to help them navigate through the rapid transformation occurring in IT today.

We want to grow at a premium to the market across product and solution categories, including servers, storage, and commercial client. As we've said for several quarters, we will grow our top-line, but it needs to be profitable growth and make sense for the overall business.

We want to accelerate and move faster in the emerging growth opportunities such as all-flash, converged and hyper-converged and high-end notebooks and gaming.

We will win in the hybrid and multi-cloud environment, which is the compute model of the future. We have great capabilities in reach and breadth both from an infrastructure and from a management and orchestration perspective. We expect that customers will increasingly look for flexible solutions and "as a service" models as they enable their digital transformation.

And finally, we will continue to work on cost and revenue synergies and driving a successful integration as we move forward.

We know we still have work to do, but we're optimistic about the opportunities ahead with the Dell Technologies family of solutions and capabilities. We expect improvement over the course of the year as we refine the alignment of our sales force and our go-to-market changes mature and as we improve storage velocity.

Now, 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, with one follow-up if you have one.

Regina, can you please introduce the first question?

Operator Our first question will come from the line of Thomas Eagan with JP Morgan.

Please go ahead.

Thomas Eagan Good morning. Thank you for taking my question.

Let's start with this. Tom, you talked a couple of times about investing back in the business. Could you expand on that a little bit? You talked about what sort of things you're doing, but maybe if you could give us sort of a bigger than a breadbox idea of how much you're putting back into the business and where on the income statement we'll see that? Is it mainly SG&A, is it going to show up as some Capex? That would be helpful.

Tom Sweet Sure, Tom. Hey, I'm happy to do that.

So look, as we talked about at the Investor Meeting in April, and as we've talked in the past, as we've looked at the areas of focus as we move the

company forward there were a couple of incremental areas that we wanted to put some funding in.

So if you think about the business units within ISG, we looked at and have invested incremental dollars into the hybrid cloud and the converged and hyper-converged capabilities and solutions. You're going to see that in a couple of spots in the P&L, in the R&D spot and in the SG&A spot.

We also have put money back in to expand and accelerate Virtustream, but those dollars are flowing in, primarily in sales and primarily in some of the R&D capabilities that they're accelerating.

If you think about Jeff's business, the client business, we're putting money into the sales area in terms of the expansion of the consumer and small business capabilities, sales and marketing I should say, as we move from 5 countries to 12 countries. We're putting incremental dollars into his R&D budget and into his marketing budget around the high-end notebooks and around the gaming capabilities.

So those are a few of the areas that we're investing in. We haven't quantified those investments publicly by line item, but our expectation is that they're sort of in a range between \$150 to \$300 million over the course of the year and we'll throttle those and adjust those as we need to, given the dynamics of the business.

Thomas Eagan

Okay, that's very helpful.

And then my follow-up question is on ISG. You mentioned softness in traditional hybrid arrays. So I wondered if maybe you could talk a little bit about why you're seeing that and if some of that softness is due to new products coming in and pushing aside some of the traditional sales or is it more customers maybe mixing hybrid with more public cloud business? If you could just give us a sense of what you saw and why you think that was a little bit soft this quarter?

David Goulden

Tom is very happy to answer that as well. So let's kind of step back and talk about the overall storage business. We said that we saw demand on a comparable basis down mid-single digits. In total, we're very pleased, we liked how we did in high-end, we liked how we did in all-flash. There's very high double-digit growth rates. We like how we did in hyper-converged, converged and hyper-converged combined. Software defined-storage was also strong.

So the area where we didn't do quite so well was that traditional mid-tier section. The IDC mid-tier price bands. And we see a couple of things there. We do have product families in that space, and we work hard to

position them. We just introduced new versions of them, which is giving our customers and our partners a boost.

We are refocusing our go-to-market teams on that mid-tier. We've got a channel program focused on those opportunities. So we think it's much more focused and clarifying our product range than it is a market area. But we think the market for traditional mid-tier arrays in total of hybrid and flash is actually growing.

So when we look at overall portfolio compared to market, which is my comment, the mid-tier band for the traditional kind of file block storage arrays, the combination of hybrid and flash is that area we are doing a little worse than the market, and we believe it's due to the factors that we spoke about.

As I mentioned, we have plans in place to address that. We just sent out new versions of our mid-tier Unity platform, new versions of our SE platform. That gives people a comfort that both platforms are being invested in. As we mentioned, we've got a sales team focused, we've adjusted compensation a little bit. We've rolled out some more directed channel programs, and we're also going out more aggressively to our big install base across both those families.

So those are the factors that kind of led to the comment relative to the market and also what we're doing about it.

Thomas Eagan Okay, thank you very much.

Operator Your next question comes from the line of Jeff Harlib with Barclays.

Please go ahead.

Jeff Harlib Good morning. This is Jacob filling in for Jeff. Thanks for taking my question.

I was wondering if you could provide some extra color on operating margins and the impact of higher component costs, particularly on the ISG side? The margins are down roughly 7 percent sequentially, and we were just wondering if you would quantify sort of what portion was driven by higher component costs versus seasonality versus pricing?

And then when it comes to servers, I'm just wondering where you see your ability to raise prices going forward and sort of what the strategy is in that market?

Thanks.

David Goulden

All right, Jacob. Thank you.

Again, let me take that. So let me kind of walk you through a little bit of a bridge from the 12 points of operating margin in Q4 to approximately the 5 points in Q1.

The biggest factor of our 5 points in total of that difference came from a combination of the volume trends, the seasonal volume obviously down from Q4 to Q1 particularly in the storage business, and the related mix that has on the overall income statement as storage became a smaller part of the business.

But also very unusual for a Q1, we actually built backlog in Q1. Think about a normal Q1, we would actually drain a lot of backlog in the changes from the fiscal to the calendar. We actually built backlog in Q1, that was a headwind compared to Q4.

So the combination of that volume trend, the mix related to it and the backlog build were about 5 points of margin. And the rest came from a number of factors, the increased commodity costs that we talked about, some pricing impacts in the market and the impacts of some of the one-time items I mentioned related to the decisions we made to rationalize some products in the Q1.

So those are the dynamics that relate to the basically approximately 7 points of operating margin from Q4 to Q1.

Relative to our servers, we are moving and have been moving to increase the pricing. We've made a number of pricing actions in line with the component costs.

But as Tom mentioned, there's only a certain percentage of that that flows through in any period of time. A lot of customers have pricing structures in place that you can't adjust until you take their next order, plus there's the kind of competitive dynamic around who is moving pricing and when.

We do expect to continue to move pricing up in servers. We've made a couple of actions this quarter. We think we'll probably have a bit more yield from that in Q2 than we had in Q1, because we've had a little bit longer to get in front of it. But that's a dynamic that's going on in the server pricing market.

Tom Sweet Hey, David, maybe I could add in terms of the component cost environment, I did mention that we have seen increases, particularly in memory and SSDs. If you just look at it spot, year-over-year, in terms of some of the memory, it's up roughly 100 percent year-over-year. And you've got SSDs up roughly in the low 20s type of year-over-year. So there is a headwind out there in component cost.

As David mentioned, we are -- we have moved on pricing in a number of areas. But that is a -- you typically can't catch it fast enough. And that's just an area we're going to have to continue to focus on as we expect that those costs -- that cost environment is going to continue to be a bit of a headwind as we go through the rest of the year at this point.

Robert Williams Yeah and this is Rob. I think it's important to remember that when you're in an environment where you've got component costs changing, either in a deflationary environment or in an inflationary environment, there's a lag effect. So we caught the benefit of the deflationary environment last year and we're pushing against that headwind in the first part and through this year.

So as you think about this over a longer time period we're pretty happy with the profitability of the business. But you're going to have some peaks and some lower points as you work through a rapidly changing component cost environment. So we'll lean into this and we feel pretty good about it over the longer term.

Jeff Harlib Great, thanks. That was very helpful.

Operator Your next question comes from the line of Frank Jarman with Goldman Sachs.

Please go ahead.

Frank Jarman Great, thanks, guys, just a follow up on that last answer. So as I understand it five points of margin was basically impacted by it sounds like some one-time items, whether it was seasonal or some of the backlog issues you were talking about. And then two points of margin was impacted by this increase in cost, input costs.

As you think about the rest of the year and these higher input costs can you just help us better understand your ability to pass through some of these to the customer base and is there a time at which you expect to sort of cross over, with regards to being able to fully pass through all of these input costs?

David Goulden

Frank, this is David, again. Let me just go back and clarify what contributed to the five points and what contributed to the rest of it. So there are three factors that contributed to the five points. One was the sequential volume change from Q4 to Q1. That's a normal factor. That, in turn, impacted mix that drives margin rate.

The unusual thing that was in the five points was the fact that we actually built backlog during Q1, which we typically haven't done prior to this. So those are things that impacted the five points.

There are three factors, again, impacting the rest, one of which was the increased component costs. The other was just general pricing pressure in the marketplace and the one-time items related to the product rationalizations we did are in the rest, so just to clarify three things that made the five points, three things that made the rest.

Now, back to your comment, I'm really going to pick up where Rob left off. So in an environment where component costs are increasing and continue to increase there is clearly a balance here in terms of we're trying to push as much of that in through the channel and raise prices and make those prices stick.

Customers, of course, don't like to pay more for what they paid for last quarter, typically in IT that's not been the case. Typically in the IT industry they're expecting price decreases on a sequential basis, not price increases.

So it's a fairly complex dynamic here, where first of all for existing contracts we've been going back and talking to customers about raising prices on their existing orders. That's sometimes a challenging conversation, but in some cases it is a positive outcome, in some cases it's not.

Then for the new orders we are trying to get the right balance between increasing our prices just at the same time as our component costs increase, trying to get way in front of that, because we want to make sure we maintain the momentum we have in the market.

Bear in mind that in the server business where this is the most acute area, we had a great quarter. We gained significant basis points in market share and we gained even more significant points of relative market share, compared to our closest competitor. So it's definitely a balance here.

At the point at which those component costs stabilize then all things kind of go back to normal and you go back to this environment where hopefully

they'll start coming down again. But in this period where they're going up there's a yield expectation, as we talked about.

A certain amount of the pricing increase will actually stick and will yield an incremental return. Others will not, because the customer either won't go there or somebody else in the market hasn't increased their price and you wind up in a competitive environment.

So those are things that go into it. It's not a precise science. But I just wanted to give you a bit more flavor as to the dynamics underneath it.

Frank Jarman

Yep, that's super-helpful. Just as a follow-up on the balance sheet, debt reduction now since EMC is about \$7.1 billion, as you mentioned earlier, it only increased by about \$100 million in the quarter, though.

So I wanted to understand, obviously you continue to prioritize deleveraging, but can you help us think a little bit more about the seasonal cadence with regards to how you're thinking about paying down debt and any kind of longer-term targets you might be willing to share at this point? Thank you.

Tyler Johnson

Yeah, look, Frank, this is Tyler. So I guess starting with your last point first, nothing has changed in our desire to get back to investment grade metrics and so we are going to be very focused on working towards that. The timing, I mean look, it's going to be a little lumpy, right. And some of this is going to be driven by the timing of our interest payments, which happen in Q2 and Q4.

Some of it's going to be our positioning for upcoming maturities. For example, in the first half of next year we've got some of the legacy investment grade stuff coming off. So it's not going to be a straight linear path, but I think if I look forward to the end of the year we are going to take more debt out.

Now I'll kind of bifurcate or separate out DFS, because that debt related to DFS, that's good debt. We want that business to grow and we saw the good growth this quarter as the originations grew. And so you mentioned a little bit about our debt going up. I mean that was the result of adding the additional structured financing debt.

So without getting into which quarter are we going to pay down a meaningful amount, just stay tuned, Frank, because you'll see this come off at a pretty regular pace over time.

- Tom Sweet And, Frank, look, it's Tom. Also remember that Q1 is seasonally our lowest cash generation quarter, given that it tends to be our weakest quarter from an overall business velocity perspective, as well as we typically see higher bonus-related payments and things like that in Q1.
- So our expectation was that we weren't going to do much from a debt reduction perspective in Q1. And I think we're right where we thought we would be at this point.
- Tyler Johnson Absolutely, if you look at our balance sheet, I mean kind of focus just on the Dell Technologies side ex-VMware, we ended the quarter with more than \$6 billion. So we obviously have some room there. And like I said, some of this is going to be around positioning for whether it be next quarter's larger interest payments. And look, we do have some areas where we've got some trapped cash that we have to be focused on. This does include the cash that we use to fund our SABs, right, so ex-VMware, like Pivotal and Boomi.
- So that's just the expectation that I'll set and what you can see going forward.
- Frank Jarman Okay, great. Thanks, guys.
- Operator Your next question comes from the line of David Phipps with Citi.
- Please go ahead.
- David Phipps Thanks for taking my question. And David, I guess you get the bonus prize for questions today, because current investors in Dell aren't as familiar with the storage business. I guess a lot of the questions are going to be around that. And so when we look at typical seasonality for the storage market, it seems like you were reasonably pleased with how the quarter went from the transition from the fourth quarter to the first quarter. And can you talk about how that seasonality plays out and through, because that sounds like operating leverage was the biggest factor in some of the margins and the margin decline in the first quarter of this year.
- And maybe you could talk about how the sales force is adapting to what is now a Dell quarter end as opposed to a calendar quarter end and what kind of disruption has that made?
- David Goulden Thank you and I appreciate the bonus question. So the storage, yes, much more seasonally variable than the server business, for example, so a fairly large ramp at the end of the year and then obviously a sequential decline in Q1. Typically the storage business then builds up from there, with Q2

being a fairly large uptick, sequentially, from Q1 to Q2, Q2 and Q3 being approximately the same amount of revenue, then Q4 being another uptick.

So absolutely, David, to your point, as we go through the year we do expect to see operating margins in ISG increase and they'll be driven by a number of different factors. So we're going to see that seasonal volume improvements, that in turn will create a mix shift back that will help.

We expect that the backlog build impacts in Q1 will kind of normalize out, and hopefully backlog will not build for Q2 or Q3. It might build and typically does build in Q4, but it doesn't matter because the volume levels are so high.

We will across the business see the impact of pricing action kick in, which we talked about. I'm going to come back to the go-to-market question because that will help drive and some of the one-time factors that we saw in Q1 we don't expect to be there.

So those are all things that will build positive going through the year.

Also related to go market, I'll come back to the specifics, we do expect to see total storage velocity improve as we move throughout the year as we expected it to from product announcements, and also just from the vetting in of the go-to-market teams.

Now to your question on the go-to-market side, obviously as Tom has talked about on prior calls, what we did at the start of the year, in January, was a very significant change. We went from two forces that were related to Dell, related to EMC, focused upon the way that they were structured, and within those structures there were differences to two combined and integrated units. So one focused upon enterprise customers, the largest few thousand customers in about 20 different segmented countries, and one focused on everything else.

So that there are a lot of moving parts in the sales force. And not surprisingly that did cause a little bit of disruption. We had to get quotas out, territory assignment, planning, training people on all the new products. So we expected some impacts in Q1. And actually when you look at it, from an ISV point of view demand grew at mid-single digits in total. I'm actually quite pleased about that given all the things that we changed in the sales structure.

And the last comment you made was relative to moving towards the quarter end. We did see demand shift a little bit out of what would have been a calendar quarter to a fiscal quarter. So we saw the quarter end

effects with more business in April than we saw in March, which would have been the traditional quarter end.

The good news was that that was a bit more smooth in terms of less of a hockey stick, if I can call it, at the quarter end than it would have been when we were still tied to the fiscal quarters. So all in all with everything else moving on, I'm quite pleased about that.

The one comment I will come back to is, of course, that demand shift means we didn't have a traditional month three in the calendar quarter, and when you see the IDC data this week in market share, we expect that to reflect the fact that essentially the quarter and moved into the next quarter, and therefore year-on-year comparison will be a little funky.

David Phipps

All right, that helps very much. Thank you.

And can we talk just kind of on the overall component costs? You mentioned it's not nearly typical that you go back to your clients and say, hey, memory prices are up 100 percent year over year, and we'd like to charge you more sequentially.

So two things. One, has the rate of increase on memory prices, has that slowed recently? And where do you peak out on the year-over-year ramp? It looks like it's sometime in this quarter. And have you talked to some of your customers and maybe one of the things that has happened when memory prices have changed, you said, well, we'll use a little bit less memory or a little bit slower memory. So how is all that process going?

Tom Sweet

Hey, David, it's Tom. Let me take that.

So I would tell you that from a pace of -- you don't have perfect clarity here, but our expectation is that Q2 is the most significant move in terms of component cost increases, although right now we're also looking into Q3 and seeing where we originally thought it might stabilize and perhaps even potentially drop, it now looks like it's going to continue to rise on us, but perhaps not at this speed, as fast as it has been over the last quarter or two.

So I think that we still have to -- and all of this, obviously, is a function of the demand/supply balance out there in the market. So to the extent that demand softens in some of the other areas where memory is used, and that perhaps will help us on the PC and server memory. To the extent it stays strong, then I think the dynamics are going to continue to be tight from that overall balance.

So it's one of those things that we periodically go through from a cycle perspective. It's been five or six years I think since we last went through one of these cycles where we got into an inflationary environment, but that's where we are right now. And, again, that's just part of being in this industry, and we're going to have to work our way through it.

And so look, I'm optimistic that we'll manage our way through this, but there is a lot of moving pieces here.

In terms of your question on, hey, as you think about how do you manage your way through it, do you go back and talk to customers about perhaps descaling their memory inputs. And that's as well that would be a logical conversation that generally is not what we're seeing. In fact, what we are seeing right now is increased memory on the Uniserve going out given all of the demands of the application environment and workloads today.

And so it's a bit of a double whammy if you think about it. We've got incremental component cost increases as well as you've got more memory on a per unit basis, and the combination of that puts some pressure on the pricing dynamic that you've got to work your way through.

But that's what we pay the organization to go out and manage their way through, and that's what we're all trying to adjust through all of the actions that David mentioned, whether it's list price moves, conversations with customers about raising contract prices, all of those levers are being pulled in a balanced way such that we don't stall the business. And that's what we're trying to navigate through.

David Phipps Okay, thank you. That's all of my questions.

Operator Your next question comes from the line of Arun Seshadri with Credit Suisse.

Please go ahead.

Arun Seshadri Good morning, everyone. Thanks for taking my questions.

First, probably a question for Tyler. I just wanted to understand the working capital for the balance of the year. Are we still pretty consistent with our original expectations of some modest cash recovery from working capital fort eh balance of the year?

Tyler Johnson Yeah. Hey, Arun, that's exactly right. I think the last quarter, if you look specifically at DPO, it probably kind of unwound a little bit. And so you are seeing some of that benefit come back this quarter.

And then, look, in addition to that, you're starting to see really some of those working capital initiatives. You're seeing some of that flow through DPO as well. So there's always going to be some seasonality and fluctuations in how working capital adjusts quarter over quarter.

But to your point, I think as you work through the end of the year, you will see some benefits coming in.

Arun Seshadri

Got it. Thank you.

And then just a broader question, probably for Tom, just wanted to understand on the cost side are you thinking about any sort of additional cost savings plans or sort of any acceleration on that front since it sounds like you're expecting the margin from the component side to be a little bit sort of -- continue to sort of be elevated in terms of pressure for the back half of the year?

Thanks.

Tom Sweet

Hey, Arun. Yeah, look, I mean, we're on track on our synergy, on track on our synergy given the actions that we've been driving.

Look, the reality of our business is we're always looking at costs. So it's not like we set a target and we all go away and do something else. And I know you didn't mean it like that. But we're constantly looking at are there other efficiencies we can drive and what can we do to improve the cost structure.

And so we're continuing to look at that. We're already into sort of into the next generation planning around cost and what's the activities we need to get at. So we're monitoring sort of the status of the business as we move through the year, and we're ultimately looking at how do we deliver operating income. And so the levers we're pulling are around what kind of margin delivery do you have versus the cost environment to the extent that things are moving around, and we'll adjust as we need to as we go forward.

So I'm optimistic on our cost programs and we'll continue to take a look at them and balance that as we go forward.

Arun Seshadri

Okay, thank you.

Operator

Your next question comes from the line of Dan Fuss with Morgan Stanley.

Please go ahead.

Dan Fuss

Great. Thanks for the question.

You mentioned consumption models earlier, I believe it was in the context of the hyper-converged products, if I heard correctly, but could you just clarify which products you expect to see kind of the most change in terms of consumption models? And perhaps if there's any way to quantify it how much of the revenue base you could see this in?

David Goulden

Yeah, Dan. Let me start, this is David. I'll talk to you about kind of what we announced and where the product impact is.

So we announced a couple of new programs. One is called CloudFlex, which is basically a fixed and reducing monthly payment that applies to a hyper-converged system. So you're right, our XC series, and the xRail, very simple. A customer signs up, we ship them the box. They have a 12-month minimum, and if they don't like it after 12 months, they stop paying and return the box to us. That obviously puts that product on our revenue recognition.

There's another offering we introduced called Flex on Demand, which applies to things that we can meter or monitor. So that could be storage arrays, it could be our data protection appliances, etc. And in that environment the customer basically is charged based upon usage.

And then we do have the ability for certain situations to go to a full broader data center utility, if the customer wants to take their entire environment and put it into a variable mode.

So those are the three things that we announced. And obviously CloudFlexers like to hyper-converge, there's Flex on Demand, there's more storage and backup and the data center utility could be a broader engagement across the full portfolio, with the customer

And finally our software license agreements, we also -- we introduced some changes to those, we call them our Transformational License Agreements, TLAs. We make them more flexible for the customer in terms of the customer's ability to substitute titles and pay for maintenance when they start using things, rather than all up front. And that was applied to our software portfolio, so Dell EMC.

So those are now the four things that we rolled out at Dell EMC World in terms of our impact.

And finally, I'll turn it over to Tom or Tyler.

Tom Sweet Hey, let me also reference the fact that as we announced at Dell EMC World, we also announced the PC as a service model and so I think overall -- which is the opportunity for customers for one monthly price per seat to get the hardware, the services, the support model all wrapped into one price.

And so we are seeing significant interest in customers thinking through how do they convert Capex to Opex, how do they provide more flexibility in their cost structure. And so all of the programs that David just talked about and the PC as a service are generating pretty good interest from a customer perspective.

And so we're happy with the receptivity. It's early. The impact today is relatively small. And generally they don't have a significant cash impact. But we're optimistic that there's a framework here that is attractive to our customers in the sense of how do they manage their own economics, even as they make their digital transformation.

Question Great, all right.

Robert Williams Sorry about that, I didn't mean to cut you off, all good.

Operator We're going to take one more question, Regina.
Our final question comes from the line of Steven Milunovich with UBS.

Please go ahead.

Steve Milunovich Great, thank you. I wonder if you could comment on your ability to raise prices on PCs relative to servers. HPE has talked about trying to raise server prices, but having difficulty in the U.S. and Europe due to price competition.

And then I also wonder if you could comment, you mentioned that your cloud volume business was weak, is that specifically hyper-scale and is that temporary or is that something that's going to be more ongoing?

Tyler Johnson Let me take the PC comment and then maybe, David, you'll take the cloud question.

Look, I mean the PC pricing dynamic first and foremost as all of you know, right, it is a pretty competitive pricing environment out there, but having said that, we have been able to move prices up. Now, again, you get a yield effect, right, because the quarter you do it you don't get the entire impact and you've got in our business, given the direct model that

we have in many instances, you have a pool of quotes out there that you have to work through.

But we have been, I would say, reasonably successful in adjusting prices and that adjustment comes in a number of ways. One is it could be list price, it could be the pricing authority that we give our sales organization and perhaps lowering those discount thresholds a little bit, or adjusting those discount thresholds to narrow their pricing flexibility. And in many instances it's also about ensuring that we're configuring the right product for the customer needs.

And so, much like the motion we have in servers, it's a variety of actions that we're driving here to manage our way through the cost environment. And so, again, I think this just is a fact of life in the business that we're in that every so often we're going to hit these cycles and I think it's going to be up to us to ensure that we execute our way through this in a way that manages the P&L as best we can, given the environment.

And remember that we're doing all these pricing adjustments while not wanting to stall out demand, because we are pleased with the velocity of the business and the PC business, the client business had a really nice quarter. So the last thing we want to do is shut that spigot off. But we do want to try and feather this a little bit, in the sense of trying to creep margin dollars up as we drive through the year.

So that's the activity we have going on, work to do, and part of that will also depend upon how the component cost environment behaves as we go through the year in terms of our overall success in being able to do that.

David, did you want to address that cloud comment?

David Goulden

Yes, I do. I think he's taking out the dynamics in the server business where, as I said, our mainstream PowerEdge business, we saw units of revenue up double digits. We are getting significant share points in terms of 200 basis points of unit share, 260 basis points of revenue share in mainstream.

And as we said, on the call, the high volume in terms of volume of servers going out, but still a small percentage of our overall server business, that business going to cloud hyperscale providers was down during the quarter. Bear in mind that tends to be lumpy. And it's also lower octane fuel, lower octane business than the mainstream PowerEdge. So those are the guidelines we talked about inside servers, if that helps.

Tom Sweet

David, and let me just add one other thing on the PC space, which is I failed to mention it, as we think about how do we manage margin, if you will, as we go through this, one of the things you've got to remember is that we have an advantage with our direct sales forces, our attach motion.

So one of the things you also try to do in an environment like this is make sure that you're attaching extended service opportunities, S&P opportunities. We saw nice growth in both of our -- in our attach rates, both in the server space and the client space, in terms of ProSupport Plus. And we also saw good attach and good velocity in our displays business.

So those are, again, as you think about how do you portfolio your way through some of these challenges, you pull all of the levers that are available to you.

Robert Williams

Great, all right, thanks, Tom.

That wraps the Q&A.

As a reminder, we'll be at the Barclay's High Yield Conference today and tomorrow. We're also at Goldman Sachs Leveraged Finance Conference in a couple of weeks on the West Coast. So thanks for joining us today.

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