

DELL INCORPORATED

Moderator: Robert Williams
December 7, 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, and our vice-chairman, [Product] and Operations, Jeff Clarke. Jeff has primary responsibility for Client Solutions Group and Infrastructure Solutions Group segments, in addition to leading our Supply Chain function. Also joining us from Europe for Q&A, is our Treasurer, Tyler Johnson.

We've posted our third quarter press release and webdeck on our website, where this call is also being webcast. Q3 financial results will be filed on form 10-Q on Tuesday, December the 12th. I encourage you to review these documents for additional perspective.

Consistent with prior periods, our Q3 non-GAAP operating income [excludes] approximately \$2.5 billion of adjustments. The majority of these are non-cash and relate to purchase accounting and amortization of intangible assets.

As a reminder, 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 webdeck as well as our SEC filings for more details on our total non-GAAP adjustments.

Please note that our third quarter fiscal 2017 historical results include only a portion of EMC's results, and unless otherwise specified, all growth percentages refer to fiscal year-over-year change, which may not be comparable due to the merger. Beginning in Q4, we will get to fully comparable year-over-year quarterly results.

During this call, we will generally reference 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 of our webdeck.

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 webdeck. We assume no obligation to update our forward-looking statements.

Now I'll turn it over to Tom.

Tom Sweet

Thanks, Rob.

Overall, I was pleased with the third quarter results and the momentum we're seeing in the business. We continue to see growth on the top-line, and we're seeing increasing customer acceptance of our broad solutions portfolio. We also had solid cash flow generation and improved profitability.

GAAP revenue for the third quarter was \$19.6 billion, with a GAAP operating loss of approximately \$530 million.

Non-GAAP revenue was \$19.9 billion, with strong results for client, servers and VMware. Overall, we were generally pleased with the balance of top-line growth and better profitability.

As we've highlighted over the last few quarters, we are working to improve our storage business velocity. And while we have begun to see some progress, we believe this will be a gradual recovery over the coming quarters as we ramp go-to-market resources and introduce new and innovative product features.

Gross margin was \$6.4 billion or 32.2 percent of revenue, which was a 110 basis point improvement over the second quarter, driven by pricing discipline and improved overall cost of goods sold.

Opex was \$4.4 billion, or 22.3 percent of revenue, which was down 90 basis points sequentially, as we continue to drive opex discipline across the business as we focus on optimizing our cost structure.

Operating income was \$2.0 billion or 10 percent of revenue, up 210 basis points from the prior quarter.

Adjusted EBITDA for the quarter was up 24 percent sequentially to \$2.3 billion or 11.6 percent of non-GAAP revenue. Please see slide 19 in the webdeck for more details on our EBITDA adjustments.

Now let me give you a summary view of the financial performance of the business segments, and then I will turn it over to Jeff, who will go into more detail on the segment operational highlights.

Revenue for the Infrastructure Solutions Group was \$7.5 billion, up 2 percent quarter on quarter. The sequential increase was driven by servers and networking with revenue of \$3.9 billion, up 32 percent year-over-year.

Servers delivered its second consecutive quarter of record revenue, with double-digit growth from both PowerEdge and Cloud servers on strong demand. We delivered solid unit performance, while also seeing expansion of server ASPs. Our storage revenue was \$3.7 billion and was roughly flat quarter on quarter as growth in all-flash and newer solutions like hyperconverged infrastructure was offset by softness in traditional storage.

Operating income for ISG was \$678 million or 9 percent of revenue, which is a 320 basis point increase over the prior quarter, driven by better profitability for servers and storage, as well as opex discipline.

ISG operating income is moving in the right direction, but we still have more work to do to improve the overall profitability profile of the business. We are working on balancing velocity and profitability within servers, and building momentum in storage and data protection going forward.

Revenue for the Client Solutions Group was \$10 billion, up 8 percent. Commercial revenue grew 8 percent due to strength in commercial notebooks, workstations, displays, and attached services. Consumer revenue was up 10 percent, driven by growth in notebooks and the benefits of our investments in gaming and our Consumer and Small Business key country expansion program.

CSG operating income was up 6 percent to \$672 million, which was 6.7 percent of revenue, as the team continues to execute on profitable growth, despite ongoing challenges from the component cost and competitive environments. Going forward, we're focused on continuing to drive profitable growth, especially in commercial client.

VMware had another strong quarter as revenue from the VMware segment was up 2 percent sequentially to approximately \$2 billion, and operating income was \$639 million, or 32.7 percent of revenue.

Standalone, VMware reported a strong Q3, which included the Enterprise Agreement with DXC Technology announced on VMware's Q2 earnings call. Its growth rate for license revenue, plus the sequential change in total unearned license revenue, was up double-digits year over year. License bookings for NSX grew over 100 percent year over year in Q3. The DXC Enterprise Agreement included a large commitment to NSX, underscoring the strategic importance of NSX to customers. vSAN license bookings were, once again, up over 150 percent year over year.

I also want to congratulate VMware for being named to the Fortune Future 50 list of companies best positioned for breakout growth. VMware ranked number six in the leaders' category, which is a testament to the company's forward-looking and innovative company culture.

Revenue from our Other Businesses, which include Secureworks, RSA, Pivotal, and Boomi, was \$475 million.

Pivotal again delivered strong top-line results. The team is also seeing nice momentum across its platform partner ecosystem, having recently announced over 100 global and regional systems integrators and consultancies as part of its Pivotal Ready Partner Program.

Additionally in November, Pivotal and Accenture announced that they formed a new business group, the Accenture Pivotal Business Group, to help enterprises accelerate cloud migration and software innovation.

Secureworks released its standalone earnings yesterday where it reported approximately 10 percent revenue growth to \$118 million, and continued gross margin expansion.

RSA had solid orders growth in the quarter. Customers are embracing our RSA security solutions, as evidenced by the positive year-to-date growth for all of its four product suites.

Before I jump to the balance sheet, I want to mention the Flexible Consumption Models that we offer customers. We continue to see strong demand for these solutions, as we remain focused on providing customers with flexibility, and building a larger recurring revenue stream for Dell Technologies. We saw a lower level of these frameworks in Q3 versus last quarter as the multi-year, strategic nature of these offerings resulted in variability quarter-to-quarter.

Now, turning to the balance sheet and capital allocation.

In Q3, cash from operations was \$1.6 billion, predominantly due to improved profitability and working capital benefits.

Our cash and investments balance was \$18 billion, up approximately \$2.7 billion versus the prior quarter, and includes debt proceeds from VMware's recent debt issuance.

Also, as a reminder, you will see our cash balance grow as we position our balance sheet for approximately \$3 billion of debt maturities coming due in the first half of FY19.

As we did last quarter, we discuss our debt, consistent with how we discuss it with the rating agencies, which is total debt including subsidiary debt, total debt excluding subsidiary debt, and total core debt, which excludes subsidiary debt, DFS-related debt and the margin loan. For additional detail on what is included or excluded in these balances, please see slide seven of the webdeck.

During Q3, we paid down \$1.7 billion in debt, including \$1.2 billion from VMware's repayment of legacy intercompany notes, as well as approximately \$500 million from cash on the balance sheet. We ended the third quarter with \$52.5 billion in total debt, up \$2.6 billion from the prior quarter. Our total debt balance increased as a result of VMware's \$4 billion bond issuance, mentioned above, as well as an increase of approximately \$300 million in structured financing debt that funds Dell Financial Services.

During the quarter, we repriced \$14.2 billion of Term Loan debt, and Revolving Credit Facility and also took the opportunity to reposition the tranches. The combined effect of this resulted in approximately \$60 million of annualized interest rate savings and enhanced liquidity management.

Our core debt ended the quarter at \$40.3 billion, down from \$40.5 billion at the end of Q2, and \$48.8 billion as of September 2016, which is when we closed the EMC transaction.

Since closing the transaction, we've paid down \$9.7 billion of gross debt, excluding DFS-related debt, and remain fully committed to paying down debt and de-levering the balance sheet.

In Q3, DFS originations were approximately \$1.6 billion, up 48 percent, and financing receivables now stand at another record high of \$7 billion, up 28 percent, driving an increase of DFS-related debt by approximately \$300 million in the quarter.

Demand for DFS remains strong and continues to grow across our business segments as customers respond to our innovative financing offerings. As we see the financing receivable balance grow, so will our DFS-related debt as we continue to fund the business.

Jumping to our DVMT share repurchase program. We recently completed our latest \$300 million program, which was announced in August, and was solely funded through a Class A Stock Purchase Agreement with VMware. To date, we have repurchased approximately 23.4 million shares of Class V Common stock. This includes 16.8 million shares under the Class V Group Repurchase Program.

We are generally pleased with our continued cash flow generation and remain focused on balance sheet management, and debt repayment.

Let me now turn it over to Jeff to walk you through the operational highlights of CSG and ISG.

Jeff Clarke

Thanks, Tom, and hello everyone.

It's great to be here to discuss CSG, ISG, and our supply chain.

As Rob mentioned, I now lead a combined [Product] and Operations organization, the only one of its kind. As one Product and Operations organization, we will be able to drive a more holistic set of integrated, innovative solutions for our customers, from the edge to the core to the cloud.

I've been in the new ISG part of my role for a little less than three months. I thought it might be helpful if I share some of my initial observations:

First, our strategy to be the essential infrastructure provider is resonating well with our customers, who are looking to us to transform and digitize their environments.

Second, our portfolio is second to none across the breadth of the IT spectrum, from the edge to the core to the cloud.

Third, we have more complexity in our offerings than is needed, and simplification is required.

And lastly, we need to continue to enhance feature functionality and add new capabilities to our storage and data protection offerings, sharpen our engineering and product execution focus to ensure we're meeting customers' needs and expectations, and execute to our go-to-market initiatives.

Now let me provide some third quarter highlights for ISG and CSG.

As Tom mentioned, ISG's revenue for the third quarter was \$7.5 billion, and operating income was \$678 million. Both saw positive growth from the prior quarter.

As a reminder, due to the fact that the EMC transaction closed during Q3 last year, I'll be making reference to demand data where appropriate to facilitate a more meaningful year-over-year discussion.

ISG demand continued to grow trajectory in Q3 with orders up high-single digits on a year over year basis.

Server revenue and unit growth were strong for both PowerEdge and cloud servers. We are seeing higher memory and storage content in servers as customers look for more computing power to run big data and software-defined solutions. We have effectively managed pricing to mitigate ongoing memory cost inflation, resulting in higher average selling prices. Additionally, we've also seen higher ASPs as we ramp our 14th generation of PowerEdge servers, demonstrating we are capturing the value of our industry-leading R&D capabilities and innovation.

In calendar Q3, the overall x86 server industry grew in both units and revenue. We outgrew the market in units and revenue for both the mainstream and hyperscale markets, and we are a worldwide leader for servers based on both units and revenue.

Looking at revenue share, we gained 250 basis points of share on a year-over-year basis for total x86 revenue, and 400 basis points of share in mainstream revenue.

Moving to Storage, orders declined in the mid-single-digits, with solid growth in our newer storage solutions.

Our market-leading hyperconverged portfolio continues to grow triple-digits, with strength in VxRail. Demand for Isilon scale-out NAS and our all-flash arrays continued to grow in double-digits.

As discussed on last quarter's earnings call, we have implemented actions to improve storage growth, particularly in the midrange, and expect benefits of these actions to materialize through the next year.

We increased our go-to-market capacity by adding storage specialists, and we are ensuring our sales compensation plan spurs the appropriate behavior to drive long-term strength in our results.

In addition, we continue to evaluate our portfolio and are focused on developing world-class products to solve our customers' needs. For example in our midrange portfolio, we recently introduced two Dell EMC SC all-flash appliances, along with key software upgrades for our Dell EMC Unity that include in-line data de-duplication, synchronous file replication, and the ability to perform online "data-in-place" storage controller upgrades. The Dell EMC SC all-flash products will be available this month, and the Unity upgrades will be available later this quarter.

At the same time, we introduced our Future-Proof storage loyalty program, offering storage customers investment protection and multiple cost-saving benefits. The early feedback from customers and partners has been very positive.

We continue to drive hard against our operational improvements in ISG, targeting our go-to-market, product portfolio, and cost-out initiatives.

Moving on to CSG, we had another strong quarter as we maintained our focus on profitable growth, balancing velocity and share gains with margin improvement. CSG revenue in Q3 was \$10 billion, which was up 8 percent, while operating income was \$672 million, up 6 percent.

The overall PC market moved back to positive year-over-year unit growth in calendar Q3 2017, according to IDC. Dell outperformed the worldwide

market, growing units 1 percent in calendar Q3, and delivering above-market growth in desktops and in the commercial segment. We increased our global PC share on a year-over-year basis for the 19th consecutive quarter.

We continue to be the leading provider of workstations worldwide. In calendar Q3, Dell outgrew the industry for workstation units, and had a positive year-over-year growth in every region.

Our investments in gaming were evident at PAX West where we announced a new mainstream gaming laptop and gaming desktop featuring a new clear panel with polar blue LED lighting, and Alienware 34-inch Curved Gaming display. These new products demonstrate our commitment to deliver world-class gaming products for every player at every level in the marketplace.

We are also seeing success in CSG S&P and attached services. Displays were a highlight in Q3, and Dell continues to be the number one display provider in the world.

We saw higher attach rates for our premium client service offering, ProSupport Plus, for both commercial and consumer client. During Q3, we announced a new top-tier Premium Support Plus to deliver the most comprehensive support service available for consumer and gaming PCs. Powered by Dell's exclusive SupportAssist technology, it's the first and only consumer service to proactively find issues, predict problems before they start, and automatically remove viruses and optimize performance for consumer PCs.

Dell's continued investment in innovation is helping Dell drive growth across CSG. We expect to continue to take share while maintaining our focus on balancing growth and profitability.

From a global operations standpoint, we've made good progress over the past fourteen months integrating our supply chain, reducing cycle times and inventory, and we continue to look for areas of improvement, working closely with the various teams on multiple working capital initiatives.

It's been an unprecedented year of inflationary memory pricing, and we believe memory will continue to be a slowly-moderating headwind through the first half of next year.

Overall, we have a number of areas that we are working to improve, including storage sales velocity, storage product performance and positioning, and ramping up sales productivity. But I want to be clear that

we've also made significant progress over the last year. We're a leader in servers, storage, displays, workstations, and gaming. We continue to see strong demand for hyperconverged infrastructure and software-defined data center solutions, and the client business continues to gain profitable share.

I believe we offer a more holistic view and set of solutions for our customers, allowing us a higher level of innovation and integration across the edge, the core, to the cloud, and it's unmatched in the industry.

I like our hand, and I'm optimistic about our future.

With that, let me turn it back over to Tom.

Tom Sweet

Thanks Jeff.

In closing, I echo Jeff's sentiment that it's an exciting time to be part of Dell Technologies. We have made good progress across the family of businesses, including strong velocity in client, servers, and hyper-converged infrastructure; growth from VMware and our Other Businesses; and steady expansion of our DFS portfolio. We also recognize that there is still work to do to improve our storage and data protection business and to improve the overall profitability of the ISG business.

I'm generally pleased with the overall state of the business fourteen months into the integration and believe we're tracking in the right direction. We are the best-positioned company to win in today's IT environment and meet customers' needs in their digital transformation journey.

We are gaining broader acceptance as the only provider that has the flexibility and portfolio breadth that can offer a single, integrated set of solutions. This was on display in New York in October when we unveiled a new IoT strategy, division, and solutions to accelerate IoT adoption for customers. The new Dell Technologies IoT Division, led by VMware CTO Ray O'Farrell, is designed to help customers navigate and implement flexible architectures, and provide tailored solutions and services across our entire family of businesses.

As we move forward, we will continue to focus on growing faster than the market and gaining share in consolidating markets, generating strong cash flow to enable additional de-levering of the balance sheet, balancing cost actions with investments to position the company for long-term success,

and bringing the full capabilities of Dell Technologies to our customers in a comprehensive and seamless experience.

Finally, let me remind you that when we report our results for the fourth quarter of fiscal 2018, we will be comparing those results against our first full quarter as a combined company. In addition, note that Q4 of fiscal 2017, our previous Q4, was a fourteen-week quarter as compared to this year's thirteen-week fourth quarter, so year-over-year growth rates need to consider this.

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

Robert Williams Thanks, Tom.

Let's go 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 Frank Jarman with Goldman Sachs.

Please go ahead.

Frank Jarman Great. Thanks, guys, and congrats on the quarter.

I guess, I wanted to start just seeing if you could give us an update on the memory and input costs that you're continuing to see. You know there's been some market discussion about NAND (ph) prices potentially peaking over the next few months. So just as you guys work through your negotiations with the supply chain, what are you guys seeing in terms of availability and how should we think about your ability to push on some of those costs as we move further into 2018?

Thank you.

Jeff Clarke Hey, Frank, Jeff Clarke here.

A couple of things. One, I suspect, given the basis of the question, you have seen what we have gone through, which is the longest inflationary period that I can recall in memory in a decade-plus. And that's a byproduct of two things. One, there hasn't been any new DRAM capacity brought online, and then the consumption of DRAM is at the highest

rates we've seen. In fact, our own server group, we've seen our memory density that we ship per server go up tremendously on a year-over-year basis and sequentially as well, so putting tremendous pressure on supply.

As a result, our outlook is DRAM pricing, while moderating in its inflation, it still continues to go up through the first half of next year. And we think NAND is moderately inflationary as well through the first half of next year. We see all-flash arrays just driving tremendous demand for more NAND, and we're pressuring the capacity that's available.

Does that help?

Frank Jarman

Yes, that's super-helpful.

And then, I guess just as a follow-up, I wanted to ask you a question about tax reform, since it looks like you guys have been focused on it with the Build Coalition Announcement that was made last week. And I guess specifically I wanted to better understand how you're thinking about the 7-1/2 percent proposed tax on illiquid repatriated, unrepatriated foreign earnings. Do you know what that taxable foreign earnings amount would be for you?

Tom Sweet

Look, I'm not going to get into this. This is Tom, by the way, Frank. So I'm not going to get into specifics about where the proposed legislation is right now. Clearly as we have been, we are a supporter of tax reform. We do believe that the U.S. system, which hasn't been reformed in over 30 years, does need some updating. And we're big fans of territorial tax and those types of policy changes that they're contemplating.

Obviously there are some headwinds in that tax proposed legislation that we're looking at and that we're making sure that our voice is heard, whether that's around the repatriation, which we're generally -- you know, we've sort of reconciled ourselves to the fact that repatriation is going to be part of this, and also things like the interest deductibility which is a potential headwind for us that we're talking to our representatives about how we might -- how they should think through some of the impacts given that it's effectively an anti-growth strategy if you think about how debt has funded job growth and capital growth or company growth here in the U.S.

So again, I'm not going to get into the specifics about what are specific aspects of the bills and how we would navigate through that. I will tell you that we'll see where this lands at the end of the day, and then we'll

take the appropriate actions to ensure that we're best positioned as we can be to move forward.

Frank Jarman Got it. I guess, just so I understand, if I were to look at your 10k it looks like the undistributed book earnings from your foreign subs was about \$79 billion at the end of last year. We shouldn't be applying a 7-1/2 percent tax rate to that basis, should we?

Tom Sweet No. Look, I think there's other factors that you have to think your way through from that number. So I don't think that's the appropriate calculation you should be doing at this point.

Frank Jarman Okay, great. Thanks very much, guys.

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

Please go ahead.

Jeff Harlib Hi, good morning. My question is on margins, both were very solid in CSG and ISG. And I'm wondering if you could just talk about the margin profile in both of those businesses. You're well above your 4 to 5 percent prior target in CSG, and ISG we have had DRAM continue to increase recently, and your mix seems like it would be negative with storage lagging growth in server business, which is a lower margin business.

So if you can go through that in terms of the margins?

Tom Sweet Hey, Jeff, it's Tom. Let me do that and then Jeff can add some color commentary if you'd like.

But, look, I think overall there's a couple of things affecting our margins as you look at it quarter to quarter. Clearly, as Jeff highlighted, component costs have been inflationary on us and so that's been a bit of a headwind clearly. I think as you step back and think about, though, it's pretty consistent with what we've talked about in prior quarters, which is that we have been adjusting our pricing to ensure that we are capturing an increase in costs coming from the component cost increases.

So as we look quarter on quarter we have seen our pricing effectiveness and the stickiness of that pricing effectiveness has been helpful for us. We also have been helped by things like mix, in the sense of the mix of the business, has been helpful for us and so we've also been helped. And we've had a little bit of FX, as well, as you've looked at what's happened with currency across the globe.

Those three have been helpful. And then on the downside of that we've also had continued impact of component costs, which has been a bit of a headwind for us in Q3. So particularly on the ISG side it relates to your comment around, well, geez, given the fact that storage is soft and you drove servers, we got a pretty good boost on server velocity and the related pricing actions that we've done out of that.

And then mix within the configurations and within the families has been helpful. So because of that, I mean you've seen our ISG margins, they roughly went up almost 200 basis points. And then the CSG margins quarter-on-quarter were obviously less than that in terms of absolute movement, but still not moving in the right direction.

Jeff Harlib

Okay, great. And just --

Jeff Clarke

I had a couple of other thoughts to build on what Tom said. One would be I mentioned earlier that our average server going out the door is going out with more DRAM and going out with, excuse me, more NAND, a bigger SSD. And that's a direct result of us selling higher up in the value stack.

We're selling higher value workloads. We are selling higher value solutions and extracting a value for that. Our 14-G servers that we just launched are selling at a premium to their predecessors. So we are seeing our ability to sell the value of our product in the marketplace and servers continue to, I think, perform quite well.

The other part is I think the global supply chain that we have and its size, we have DRAM. So as much as I said DRAM is going up in cost, we have it. And we're getting a value for having it. And whether that's in our PC business, in our server business, I think that is something customers are coming to us for, knowing we had supply and they're obviously paying for it. So we're seeing our margins continue to improve and our prices improve there.

And then Tom mentioned the element of mix in the PC business, that's very true. If you look at our relative performance of commercial PCs to consumer PCs, that's a strong contributor to margin improvement in the PC business.

Jeff Harlib

Great, that's very helpful. My follow-up just would be any general commentary you can provide on the 4Q outlook, given this is the first full pro forma quarter, with respect to revenues, margins in each of the segments?

Tom Sweet

Hey, Jeff, it's Tom. Look, you know we don't do forward guidance, right? So let me just start with that comment. I will tell you that if you look at historical seasonal patterns you expect to see roughly a six to seven percent sequential bump in revenue, if history were to be consistent with what we're seeing this quarter.

So that's something you should think about and then remember that seasonally we turn down in Q1 after that, right, in terms of just the nature of how the business flows.

But look, I mean, absent that I will tell you that the only other thing I would put in your thinking is we've talked about it. We talked a lot about this in Q2, on the Q2 call, around these flexible consumption models. And we had a fairly healthy dose of flexible consumption models in Q2. In Q3 they were less.

And remember, these were models where we're typically offering the customer more flexibility and therefore I'm deferring the revenue. And therefore, well, I'm getting in some cases getting the cash up front and not recognizing the revenue up front now.

We'll have to see how Q4 plays out in terms of those flexible consumption models. But seasonally, it's a pretty big quarter for us from a revenue perspective, so we'll have to watch that dynamic and mix as we go through the quarter.

Also remember, and I said it in my talking points, that last year was a 14-week quarter for Q4 and this week will be a 13-week quarter. So just keep that in mind, too, as you think about the year-over-year compares.

Jeff Harlib

Great, thank you.

Operator

Your next question comes from the line of David Eller with Wells Fargo.

Please go ahead.

David Eller

Good morning, thank you for taking the questions. You talked a little bit about expectations for memory in 2018, but I wondered if you could provide some more color around your kind of whole basket of inputs, so maybe panels, displays and kind of maybe the whole basket for 2018?

Jeff Clarke

Yeah, we see the other commodities showing slight signs of deflation, not enough to offset the inflation of the memory devices, but if I was to look at batteries, LCDs, metal, printed circuit boards, discrete components, we

see a slight deflationary marketplace for us next year that's helping us offset what's happening in DRAM and NAND.

David Eller

Great and then can you talk maybe also about the ability to take out non-commodity related costs?

Jeff Clarke

Well, we clearly are doing that across a vast number of synergy activities in the organization. I can speak specifically to the product in the supply chain side and I'm sure Tom will jump in on the rest of the portfolio or the business. We have a plan. We're executing to that plan. I mean quite honestly, we're on that plan. We have applied our Dell pricing terms across the broader purchase of our entire portfolio, which you would have expected us to do.

Last year we had that done certainly on day one. We're reaping benefits of that throughout this year. We've seen tremendous efficiency in the supply chain, particularly through cycle time improvement, lead time improvement to our customer base, and managing our working capital initiatives through our facilities, most notably in the form of inventory. So I think we're well along the path of managing our other costs outside the commodity and the supply chain on the product side.

Tom Sweet

Yeah, that's fair, Jeff. On the overall cost synergy we obviously have put that 2 billion target out there. We also had told you that we had made some incremental investments back in the go to market and the business that were going to probably delay the full cycle of how those cost synergies would flow through. I think we've been pretty up front about that.

We remain on track on our cost activities. Even considering the investments that we've been making and we'll continue to evaluate the business. So the goal here is to drive the right level of profitability across the combined entity. And we'll do that through pulling various levers to ensure that we, over time, deliver the right EBITDA generation that we're targeting.

But, you know, I also tell you that we're also in this for the long-term, right. So we are making appropriate investments to position the company as we think about where we want to be in the three to five-year range, as well.

David Eller

Okay, Tom. And then a lot of times I do get questions from investors around maybe the amount of incremental investments that have been

investing back into the business. Is there any way you can kind of scale that for us or help us understand maybe when that 2 billion target might be achieved?

Tom Sweet

Look, I mean, I think we've told you that the incremental investments have been in the hundreds of millions of dollars but we haven't quantified it specifically and I'm not really -- don't really want to go there.

The dynamic that you have, though, obviously is that from the business continues to evolve and the environment continues to evolve. So we're continuously looking for cost out opportunities and efficiency opportunities. That's just part of the DNA of the company.

And so what we had said earlier in the year that we were probably delayed a year or so, in terms of realization of those synergies, as we moved forward given the investments back into the business. So I still think that's a reasonable position to be in.

Jeff Clarke

Thanks, David. Just as a reminder to everyone as we move forward: One question with one follow-up, so we can get to as many people as possible.

So, Regina, next question.

Operator

Your next question comes from the line of Thomas Egan with JP Morgan.

Please go ahead.

Thomas Egan

Good morning, hey, I just wanted to follow up on the margin question. I appreciate all the qualitative stuff that you've given us, but I was wondering out of the 320 basis point sequential improvement in ISG margins, if you could help us out understanding how much of that was servers and networking and how much of that was storage, because you pointed out that you had better profitability from both.

Tom Sweet

Yeah, hey, look, I'm not going to get down to that level of detail. I mean, we did see benefit from both the velocity in servers, and the price expansion, I'll say, in servers given the configuration mix that we're seeing in the business.

So I would tell you that servers, and then we got better pricing and better mix in storage even as volume wasn't quite where we wanted it, and then we've got, Jeff highlighted it, the fact that we are loading a heavier mix of memory in NAND on some of these products and, therefore, that's helping us as well.

Also, I would point, remember, that as you look at that we also got benefit from Opex, right, in the quarter. So I think the team did a reasonable job with managing Opex and very generally pretty pleased with what we saw in terms of profitability expansion. It's not where we want it yet, so I want to be really clear about that. Yes, we made some progress. We had a lighter mix of flexible consumption models in the quarter, so therefore I didn't defer as much revenue and profitability as perhaps that you saw in Q2. That's going to vary quarter by quarter, so you've got to keep that in mind.

But I think overall I'm pleased with the progress this quarter, but clearly more work to do.

Robert Williams Just a reminder, when we talk about this before, there does tend to be a bit of a lag effect on pricing, particularly with the larger customers, where we've committed to a certain level of pricing. This impacts ISG more so than CSG.

So as we get a couple of quarters into some of these price moves, we tend to be able to catch up a little bit better.

Jeff Clarke And you saw the acceleration of a couple of our premium products, our XtremIO X2 grew quarter over quarter, our all-flash array business across the portfolio grew. They generally carry higher margins.

Robert Williams And 14G went from, we're not going to give the percentage, but 14G increased pretty significantly as we went to the 14th generation of servers.

Thomas Egan And then for my follow-up maybe, since I couldn't get a breakdown of the three, if Rob would let me, I'll just do sort of a two-parter. (Laughter.)

Robert Williams You guys are killing me. Go ahead.

Thomas Egan You talked about repaying a debt, and you talked about doing it with cash. So maybe you've got \$11.7 billion of cash on the balance sheet as of this quarter. Could you talk about how much of that is in the U.S., remind us historically is the current quarter a bigger than usual, average, or less than usual cash generator?

And then the EMC bond, the \$2.5 billion that comes due beginning of June, are you expecting to pay all of that down with cash or is there any chance that you look to refinance?

Robert Williams Hey, Tyler, why don't you take that question since this is right down in your power alley.

Tyler Johnson Hey, Thomas, I hope you guys can hear me okay.

So first, just as a reminder right when you're looking at that cash balance, that's also including the VMware cash. So remember the Dell Technologies ex-VMware, which is how I think about it when I'm looking at debt paydown, it's a smaller number, right. So call it somewhere around a little over \$6 billion, \$6.3 billion.

You know, the geography of that cash obviously moves around kind of depending on what's happening in the business and different intercompany forms, but I think at any given time we have probably 35 to 45 percent of that sitting in the U.S.

And just like we said, right, we try to keep the balances low taking into account we do have places where maybe the cash is restricted or tied up. We've got investments on the books and that type of thing. But the focus is going to be take that excess and paying down debt.

And just like Tom mentioned in the talking points, we're going to probably conserve cash. You asked about Q4, seasonally Q4 tends to be a stronger cash quarter, so that would be my expectation. But then that's followed by Q1, which typically tends to be a weaker cash quarter as we pay off things like certain tax payments and some compensation and that type of thing. So I've got to prepare for that.

And we've got those two maturities, so the one it grows a little bit smaller. And that June maturity, my expectation is that it's going to be funded through a combination of cash currently on the balance sheet, cash flow generation between now and then, and I do have the untapped revolver. So if I need to dip into that to fund a portion of that, I have that available.

And keep in mind, if I do do that, that's purely temporary. So we use that to kind of fund some of these inter-quarter gaps, typically. And so if I did that it would only be for a short period of time.

My expectation is, one again, we've got about \$5-1/2 billion worth of debt coming due when I include the amortization payments for last year on the term of a lot of these. And I'm looking to pay that down with cash over time.

Thomas Egan Great. Thanks.

Operator Your next question comes from the line of David Phipps with Citi.

 Please go ahead.

David Phipps Hi. Thanks.

 Tyler, just following up on the last question, those next two maturities just happen to be noninvestment grade bonds and when you're thinking about paying down things in cash, is it just that they happen to be noninvestment grade bonds that you're paying down and maybe thinking about in the future paying down other noninvestment grade bonds, maybe refinancing some of the investment grade bonds, and how is Dell thinking about that as they go forward?

Tyler Johnson Obviously, I would love to be able to pay down the most expensive debt first, but as you know it's not all pre-payable. So look, I think we'll pay things down as they come due. If it makes sense for whatever reason or if there's a good opportunity to refinance, I'm not saying that's off the table. I mean, that's always a consideration as I'm trying to optimize the balance sheet and the capital structure.

 And we'll pick a part of the term loans, right, that's the stuff that's pre-payable and it's easy to take out. I've got the A1 is gone now, so that's nice to see that's no longer in my capital structure. I've got the A3, which is due at the end of the year, so that's embedded in that \$5-1/2 billion number I threw out earlier. And then we've got the A2 and the Term Loan B down the line.

 So look, I think we'll continue to do what we're doing, deleveraging, paying down debt will be the focus. But I don't want to say that refinancing opportunities are not existent or something I wouldn't consider.

David Phipps And just as a tag on to that, then I want to ask another one for Tyler, the --

Robert Williams Only two, guys. Pick one.

David Phipps Then, Tyler, just tell me about if we have a generally richer mix for servers than storage in the fourth quarter now that we look at the new Dell?

Tom Sweet Let me take that. That's more of a Tom question than a Tyler question, although Tyler is welcome to jump in on that.

Look, again, we don't get into projecting future results, but I would tell you if you just look at the dynamics of the business right now, clearly we are seeing extraordinarily strong server velocity and demand for lots of reasons, more compute-centric solutions being driven, ASPs are up as Jeff mentioned in his talking points because of the rich mix of pricing actions to component cost inputs have gone up.

So it's really about Q4, if you look at seasonally, historically, this would be an extraordinarily strong storage quarter. And I do think that we do think that we'll see some of those old seasonal patterns hold. The question is how strong are servers going to be.

And so we expect, I have to see how that plays out, but historical seasonal patterns would tell you that storage should be, this is typically the strongest quarter of the year from a storage perspective, and you do see at times end of the year budget flush form some of the corporate customers as they're finishing their projects and their budget cycles, and therefore we'll have to see how that plays on the server activity as well.

- Jeff Clarke But just to be clear, we're not slowing servers. Our job is to speed up storage.
- Tom Sweet I told Jeff to go fast on both, that's not really very helpful from Jeff's perspective, which is what he's trying to do anyway. But our job is to get this business where we want it and we've got work to do on storage as we all have talked about, and I'm pretty happy with server performance and we just want to keep going on that.
- David Phipps Thank you. That's my question and follow-up.
- Robert Williams Thanks, David. I'd have given you another one, David, but.
- Operator Your next question comes from the line of Adam Willinger with Bank of America.
- Please go ahead.
- Adam Willinger Hey, thanks for taking the question. So another question on the flexible consumption model, so first do you think that the low proportion of these deals in the third quarter, or is it the second quarter, is like an anomaly to kind of the longer-term trends? And then do you have any visibility into how these types of deals are trending in fourth quarter?

Tom Sweet Yeah, look, I do think that you shouldn't read anything into the fact that Q3 was a little bit softer than Q2 in terms of flexible consumption models. You know, I think these things are going to vary. They're complex. They're multi-year. They take time to negotiate. They're typically the larger customers, the global customers that are negotiating these types of arrangements and so I think we are going to see some variability.

I think all things being equal it's entirely conceivable that we'll see an uptick in flexible consumption models in Q4, just given natural end of the year sort of activity, both from a customer and from a Dell Technologies perspective. But we'll have to see how that plays out.

Adam Willinger Okay. And then still kind of on that topic, I think you touched on it briefly in one of the prior questions. But the presence of these kind of flexible consumption models, does it impact kind of how you recognize margin for the business, those kind of on a short-term and over the life of the relationship? And I'm trying to think if it's still fair to kind of think about incremental margin for storage in kind of the 50 percent area?

Tom Sweet Well, look, I mean we like these flexible consumption models. They do have the effect, as you guys all know, of deferring recognition of revenue and amortizing that revenue and associated margin over a contract cycle that might be two to five years, dependent upon the term of the agreement.

So historically what we have seen is over time these tend to be over the course of the contract period they tend to be a better profit -- they tend to have a better profitability profile, but it ramps. So it starts a little lower and ramps over the course of the contract.

So on an all-in basis margin dollars generally have shown to be higher over the entire length of the contract, but it does change the timing pattern and pattern of when those are recognized. And so remember, we like these constructs in the context of building a more intimate customer relationship, ensuring that we are a more strategic partner for these customers. And it builds more of an as a service revenue stream or recurring revenue stream that's helpful for us.

And, you know, we've got the flexibility being privately controlled to do these types of structures and not be as focused on short-term, quarter-to-quarter profitability, although clearly we're all trying to -- we are trying to drive the profitability of the business. But we do have some incremental flexibility here.

Adam Willinger Okay. Thanks so much.

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

Please go ahead.

Shannon Cross Thank you very much for taking my question. Jeff, can you talk a bit about the competitive landscape on the storage side, both in terms of some of the newer technologies as well as what you're seeing in sort of legacy?

Jeff Clarke Sure. Hi, Shannon. How are you doing?

Shannon Cross Good, good.

Jeff Clarke I think a couple of things that I look at the marketplace and, as I'm learning through my first three months, it's a big market that we get confused, that we think is shrinking. The external storage market grew last quarter. It's a \$24 billion market, it's a big opportunity. We have a big, big opportunity with our 30 percent share to grow in this market and that's what we need to do.

Clearly the competition is NetApp and Pure most notably. What I see about them is they have extreme focus and they have clarity in their product line and I think they're reaping a benefit from that. Some of my remarks are about pivoting our organization to that. I think we mentioned last quarter that we're going to invest in more sales specialist capacity.

We hired more sales specialists in Q3. We're going to hire more sales specialists in Q4. We're going to build out that investment. Tom actually talked about investments. One of the areas we consciously have decided to do is build out more capacity for more coverage in the mid-market commercial segment.

And that's not at the exclusion of the enterprise segment either. We're building out more sales capacity in the enterprise. We're moving sales leadership between the organizations so we can get more storage and knowledge base in our commercial organization.

We're making adjustments and continuing to tweak our sales compensation more biased towards storage. We just made two significant updates to the product portfolio. We added de-duplication in Unity and we added an all-flash offer to our SC product line in the mid-range.

Our XtremIO, which is I think a very differentiated asset in the marketplace, particularly against the two competitors that I mentioned earlier, with its in-line data services and its performance attributes is a great product.

Another thing we just launched in the last I think it's week or 10 days, is a new customer loyalty program, which if you compare it against the competitive landscape is absolutely unmatched. Our competitors basically guarantee their product or program for 30 days. We guarantee ours for three years. It's got seven key components in it. Basically it's an investment protection with a set of guarantees for our customers that, quite honestly, the industry analysts and our customers have responded quite well to, which I think is upping our competitive nature.

So I think we're in a big market. It's a big opportunity. We clearly have lost share. It's undeniable the public results are out. We're not satisfied with that. We're investing in sales capacity and coverage and expertise. We continue to add to the product portfolio and its competitiveness.

We needed de-duplication in Unity. We needed all-flash in the SC. We need to continue to drive the performance advantage we have in XtremIO. We now have a set of loyalty programs that, again, I believe puts us in a position to walk into customers and say there is no risk picking us or pulling out the competition and here's our guarantee behind it.

I don't know if that answers your question. I'm happy if I didn't to go into more detail.

Shannon Cross No, I think that does. I'm curious, versus prior leadership in ISG, any changes that you see in terms of how you're going to approach maybe the integration between the two businesses, clearly you're investing in certain areas. It sounds like a lot of that maybe was already underway. So I'm just curious how you're working with the EMC assets.

Jeff Clarke Well, our Dell family of assets, we try not to refer to them as EMC assets. It's the Dell family assets.

Shannon Cross The family.

Jeff Clarke I'm absolutely going to integrate top to bottom, one team. You may be aware of some of the more siloed orientation of the previous organization. That's not going to be the case going forward. We're going to look at the

storage portfolio. We're going to make decisions across the portfolio in the best interest of our customers.

When I look at the high-end storage stack, the midrange storage stack, the low-end across data protection and ACI, we are going to work more seamlessly across the organization and build the right number of products positioned appropriately in the marketplace.

I mentioned in my remarks, we have a bit of complexity in the portfolio. We're going to make it clearer for our sales force and clearer for our customers what products to buy for what applications or environments. That's something we can do and we will do. And it's going to be across the entire portfolio.

I don't know if that answered your question.

Tom Sweet

Jeff, that's a multi-quarter journey.

Jeff Clarke

Given the cycle time of product development, given the commitments we've made to customers, we will work through this. But complexity doesn't mean less products. Complexity can mean the number of offers per product, how many countries we offer a product in.

Interestingly, we treat the 180th country the same way we treat the largest country in the world. It's not clear to me the 180th country in the world needs all of the entire storage breadth of our portfolio, and we can make that less complex, easier for our sales and marketing teams to communicate, and much easier for our customers to buy.

So you'll see us work on that over the next handful of quarters.

Shannon Cross

Great. Thank you so much.

Robert Williams

Great. Thanks, Jeff.

Thanks, Shannon.

Thanks to everyone for joining.

Quick reminder, in early January we will be at CES with the full suite of consumer and gaming products, and invite anyone that's out there to reach out to us. We'd be happy to speak with you. Come by our show.

So thanks and have a great holiday season, everyone.

Operator This concludes today's conference call. We appreciate your participation.
You may disconnect at this time.

END