TRANSCRIPT

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PRESENTATION

Shannon Cross:

Hi everyone and thank you for joining us. My name is Shannon Cross and I'm the IT hardware analyst here at Credit Suisse. Today I'm pleased to be joined by Chuck Whitten who is the co-COO of Dell Technologies. So prior to getting started, Dell has asked me to read the following novel.

This discussion may refer to non-GAAP results including non-GAAP operating income, non-GAAP diluted earnings per share, non-GAAP operating expenses, and adjusted free cash flow. For reconciliation to the most direct comparable GAAP measures, please consult the slides labeled supplemental non-GAAP measures in the performance review available on the fiscal 2023 Q3 results page on investors.delltechnologies.com. Dell Technologies' statements that relate to future results and events are forward looking statements and are based on Dell Technologies' current expectations. Actual results and events in future periods may differ materially from those expressed or implied by these forward looking statements. Because of a number of risk uncertainties and other factors, including those in Dell Technologies' periodic reports filed with the SEC, Dell Technologies assumes no obligation to update its forward looking statements.

With that, Chuck, would you like to introduce yourself and tell us a little bit about your role at Dell and why you joined the company?

Chuck Whitten:

Sure. Well, and thanks for reading that. I know that we ate into a chunk of our time there. So yeah, I’m Chuck Whitten and I'm the co-Chief Operating Officer. I've been with Dell little over a year, but you should sort of think of me a bit as a Dell insider, I had worked with the company for over a decade as a strategic advisor at Bain. My responsibilities are running the business for Michael. So alongside Jeff Clark, I oversee our infrastructure solutions group, our client solutions group, global operations, and we're responsible for setting strategic priorities across the leadership team, including our strategies for cloud and our new business development.

Shannon Cross:

Great. So your most recent earnings call was a bit subdued to put it mildly. Can you provide some color on what you're seeing in the current macro on a segment basis? Maybe we can discuss what you're hearing from customers as they start to set their 2023 budgets.

Chuck Whitten:

Well, sure. So last week we reported Q3 earnings. We had record $2.4 billion of operating income and EPS of $2.30. That was up 39%. That was against a backdrop of a revenue decline of 6%. So that'll give a bit of the feel for the dynamics. If I go by business, major business, the Q3 performance was very consistent with what we previewed in our Q2 earnings call. So the PC business continues to be challenged, consumer more challenged than commercial. Our business in quarter was down 17%. The server business continued to moderate over the course of Q3 and we had previewed that in Q2. I would say it maybe slowed even more than we anticipated in Q3 and our 14% revenue growth was driven by a reduction in our backlog. And so that explains our sort of performance in the server business.

And then storage hung in there. It performed well. We were up 11% on a P&L basis. We saw strength in multiple storage types, high end, hyperconverged infrastructure, PowerStore grew nicely and we'll talk about that later, I believe. So that's the kind of broad dynamics look by texture, geography, vertical, customer size; it was largely consistent, that performance. There's a few places I might call out as being slightly different than that average, China, for I think reasons everybody understands, a much more challenged environment. We saw strength in some verticals like energy, the US government segment, medium business performed better than perhaps the average. But overall it was relatively uniform dynamics and what we heard from customers was very similar to what we heard in Q2. Just a lot of caution entering the environment. I'm revisiting my forward hiring. I am looking to reprioritize within my existing IT budgets.

No one is saying I'm throwing overboard my digital transformation investments; I'm completely rethinking my technology strategy. But at minimum it's a moment of sort of caution and reflection from customers. Against that we performed really well. Our business has an advantaged model. We, given our large direct sales force, see these demand trends I think faster than the industry and it allows us to react and we like to say we focus on what we can control. And so the first thing we can control is our cost position. If you look Q1 to Q2, our OPEX declined sequentially 3%. If you look Q2 to Q3, it declined 6%. We took 300 million out of OPEX since Q1, that contributed to our profitability. Our low inventory model also drives access to deflationary components faster than the rest of the market. And so you saw that play out in our profitability as well in Q3. Our gross margins were 23.7%, very good profitability. That's up 200 basis points.

And then we focused on gaining share. So we gain share in the commercial PC business in Q3. That's 35 of 39 quarters. We expect when IDC reports results here in December, we'll gain share and server and storage. And so again, it's a challenging and uncertain backdrop, but we're going to focus on what we can control.

Shannon Cross:

Maybe could you clarify the guidance that you gave for fiscal 2024, which I know you didn't give guidance, you gave directional commentary, but it ended up with guidance, so perhaps that'd be helpful. And then also how do we think about free cash flow? Challenged this year for reasons I think you we've discussed in the past, but then looking forward, is this something where you'll see a significant bounce back, or given the challenges with PCs at least in the first half of the year, is that going to be a bit more difficult to attain?

Chuck Whitten:

Yeah, sure. Let me start with guidance and maybe the upfront caveat, which is obvious, is we're just into our Q4. It is an incredibly uncertain market and dynamic to forecast, particularly as you go into the back half of next year. But we thought it was prudent to offer some bit of guide on how we were thinking about next year. And so we said principally two things. First is you should expect our revenue trajectory next year to be below normal sequentials. And then to help you of think through what is below normal sequentials, I think Tom gave some helpful guidance in the Q&A. If you take our Q4 guidance of $23 to $24 billion, that's down 16% at the midpoint. And then you look at our second half performance, so our Q3 actuals in that guide, I think you'll find yourself somewhere around down 11% for the second half of the year.

That's probably a good starting point for how you should think about next year. And so that was the guidance we gave. Again, with the caveat, it's a very uncertain, uncertain dynamic. On cash flow, look, we don't guide on free cash flow, but I think you characterized the dynamics correctly. Look, we're a very enviable free cash flow generating business. If you look at the last four years, excluding VMware, we generate on average about $6 billion in free cash flow. That's a combination of our growth and our negative cash conversion cycle. Obviously in this environment, that negative cash conversion cycle works against us as we had sequential declines. And so what you would've seen is about $400 million in Q3 of cash flow from operations. I think we're trailing 12 months, something like $3.9 billion, so down from our historic averages.

Underneath that you would see us primarily carrying higher inventory. Couple of reasons for that. I think one obvious, we've come through a relatively unique last couple of years of supply shortages. Our business is principally the assembly of kits. And so shortages of things like NIC cards can hold up a $10,000 server. So we've held more inventory to meet customer needs. I think that that's obvious and we'll work its way down over time. And then in Q3 we made some strategic purchases that we thought were economically advantageous for the company and that's our Q3 inventory. What it is not, is a permanent change in the way we think about our working capital management. And so we're going to continue to press hard on our working capital when the market rebounds and we start to see sequential growth. Again, I think you'll see our cash conversion cycle and our cash generation come back to what one would expect. Our long term framework and commitment is that we are going to generate free cash flow in greater than 100% of our net income. And that's still our expectations over time.

Shannon Cross:

How are you thinking about the PC industry? I mean short term, lots of pressure, but from a longer term perspective, I mean there's kind of a two camps. There's one side says we go back to 250 million units annually. Another is we've reset the bar and so maybe it's 275, maybe it's 300. Once things sort wash out how, and I know no one has the correct crystal ball or you'd be going to Vegas and not be sitting here. So how do you think about it generally as you're putting together your plans?

Chuck Whitten:

Yeah. Well I think my headline is I think we've seen a profound reset in usage, but I think maybe one observation, I think we as an industry, and by the way we've been guilty of this, Shannon have done a disservice in talking about aggregate units because not all units are created equal in our industry and not all units have behaved the same way over the last couple of years. So let me give a few observations. Let's just stay with IDC data, so we all have a common currency. If you look at a commercial unit on an ASP basis versus a Chrome unit, it's 3.5 times more valuable on an ASP basis. If you look at a high price band consumer unit versus a mainstream consumer unit on an ASP basis, it's 2.5 times more valuable. And Chrome and mainstream consumer have been the most elastic up and down in this market.

And so for us and our business that is principally centered on the commercial PC business, I think it's helpful to look at units of commercial excluding Chrome and revenue as well. And I think when you unpack that, you're going to see the profound change in usage that we've seen. That profound change in usage is hybrid work. 75% of companies are now in a hybrid model. They mean that means more notebooks with a faster refresh cycle. It also means richer configurations, more peripherals. It is not just a productivity device that is our telephony, it is our video conferencing equipment. And what we hear for from customers time and time again is this matters to our employees now. And so we continue to hear it's a CIO level issue and they're going to continue to invest in the end user experience. So there's a lot of reasons to be bullish about that market. If you pull back to the data, again, stay in IDC, their latest 2023 forecast, you'll see that market, the total market up 2019 to 2023, 5% on a unit basis and 15% on a revenue basis. That's the change in usage. That's more commercial units. That's richer configurations. That's what we believe is going to happen. So despite the caution and pause right now, we're very bullish on the PC, commercial PC market long term.

Shannon Cross:

Is there a way to think about the absolute gross profit dollars per PC and how that's changed pre pandemic to now for your commercial devices? I mean prices have gone up, but configurations have become a little more rich.

Chuck Whitten:

And we don't give a lot of detail or guidance on that, but look, what I can tell you is let's look at the ASPs in our business that increased in Q3 in the PC space. It was a combination of three factors, improving mix, not just commercial to consumer, but within, in our commercial business, think more 7-series than 5-series, or more workstations than mainstream. It was richer configurations across all of those and it was more attach. So more peripherals, more services, more of our displays. For us it was a third, a third, a third. So I mean there is a real material change in the underlying content that's going into devices and the attach around it. That's good for us as the leader in the commercial space.

Shannon Cross:

No, that makes sense. Maybe if we can move to the server market. Obviously you benefited from backlog this last quarter or you saw more weakness maybe than you expected as you went through the quarter. How are you thinking about the server market and pricing as you look forward to 2023?

Chuck Whitten:

Yeah, well maybe on the market side, I think I said it in my opening, look, it's been a challenged market. It's moderating in growth. It's probably not surprising if you pull the lens back a little bit. As the market leader, we've just seen eight consecutive quarters of server growth. The industry has had high levels of backlog given shortages. And so I think you sort of put yourself in the shoes of a IT decision maker. They are looking at the macro uncertainty. They're saying, "Wow, I've consumed a lot of compute. I maybe have more coming from the industry that's on order. Let's take a moment of reflection as we rack and stack our priorities. What have I consumed? What do I need?" I think that feels like the digestion cycle we're in right now. Again, no one's canceling outright, their digital transformation investments. But that's the pause we feel. When that rebounds, I don't have a crystal ball and if you have the answer, I'd love it.

Look, pricing's a really important topic because I think it's another one we have to unpack very similar to what we just did with the PC industry. There are two trends that elevated our ASPs again in Q3 and in the server business. One is content rate. So content rate has continually increased in this market that's more SSDs, memory, richer GPUs. It's the workloads that the servers are being asked to run. And that's been a long term trend. And then it's commodity inflation and pricing for that. Back to my big animal pictures of what contributed to what, in our business in Q3, two thirds of the ASP increase was content rate. So that's an important and hopefully very durable part of the market. One third of it is related to commodity inflation.

So look, in our forward guide both for Q4 and next year, anytime you see a slowing demand environment and a deflationary environment, you should expect pricing pressure. So we're not assuming anything heroic about the way ASPs hold up. I would say we have been very disciplined in testing elasticity out there and we're going to continue to be disciplined on that. Price is not necessarily the lever right now to go out and pull. Given that I think what we're facing right now is fundamentally a demand issue of and reflection on digestion.

Shannon Cross:

No, that makes sense. Moving to storage and everyone here probably had a fun night last night looking at NetApp, storage has been resilient, I think for lack of a better term, for the last several quarters. And then we had the NetApp results, you've done well with PowerStore. How are you thinking about the market? How is PowerStore performing relative to your expectations?

Chuck Whitten:

Yeah, well look, as I said, our business held up very well in Q3. We were plus 11% on a P&L basis and we saw pretty broad demand across the storage types. So we called out high end, hyper-converged infrastructure. I'd say unstructured, PowerStore continued to grow. Look, our advantage in this market has been the breadth of our portfolio. So we're number one across all storage types, high end, mid-range entry, all flash, unstructured, data protection, hyperconverged, you name it, we lead in it. So that just gives us a position in the market no matter the storage architecture or where the pockets of growth are, we tend to see it. It held up well in Q3.

To your specific question, look PowerStore, it's a really important product for us. It's our marquee mid-range product, the first modern storage architecture put out in many, many years by us and by the industry. And it's the space that we focus on because it is the place we have given up the most share and it has performed exceptionally well. So the encouragement, it's I think the fastest growing storage architecture upon the first six to 12 months of launch. It is growing healthy now, good double digit growth, but I think most importantly it's attracting new customers to Dell and we're seeing repeat buying. So in Q3, 24% of customers were new to Dell that bought PowerStore and 45% of customers were a repeat buyer of PowerStore. So it's just an encouraging trend.

And so look, right now as you look at our sort of forward guidance, we expect another seasonally strong storage quarter as always. And we're going to continue to focus on relative share gain. Our last, I think last results for Q2, which were announced we gained 300 basis points of share, it was widespread across all storage categories. We're expecting to again, gain share. When you see the Q3 results announced here in a couple of weeks or a week.

Shannon Cross:

When you say new to Dell, is there a way to think about ones where you've lost the share, they left sort of the EMC world and they went to somebody else and they've come back? Or is the repeat buyer was the-

Chuck Whitten:

Well yeah, new to Dell, 24% would be, haven't bought storage from us in some period of time, multiple years, maybe back in the day they bought something. But no, it's a new acquisition for us for us of customer, and the 48% are those that have deployed PowerStore and said I need more of that, which is great.

Shannon Cross:

And I've been a big proponent of hybrid cloud and infrastructure service, which would be your Project APEX, over the last since they launched, I guess. And to me it seems like this is the best way for hardware companies to compete against the cloud because at least you can walk in and say, "Here's how you can price it ratably and here's how Amazon's pricing it. And maybe we can have actually apples to apples discussion." So can you talk a bit about how Dell's thinking about, I know you're talking more about Project APEX than you have prior, I think, and infrastructure as a service and how that fits in with your product portfolio.

Chuck Whitten:

Yeah, you bet. So look, as you said, it's undeniable. Customers want to talk to us about flexible consumption. They also want to talk to us about financial flexibility broadly. And we've had, given our direct relationships and our large Dell financial services capabilities, dialogues like this for many years. In fact our Dell financial services business, our leasing business, grew 17% in originations in Q3. It's a countercyclical part of our business, so it's a good asset. But on APEX specifically, look, we've been trying to solve two customer requests. One is, "Hey, I want a common cloud-like experience across my multi-cloud, multi-data center, multi edge environment. And I want flexible ways to consume. So I want the option to buy infrastructure, I want the option to subscribe to infrastructure, and I want the option to subscribe to infrastructure with your managed services on top of it." The latter two are where we have APEX focused.

And as you said, we started talking more about it. It's been very, very successful. In Q2, we announced the milestone, we crossed the $1 billion ARR mark. In Q3 it continues to grow ARR at a healthy clip. We're adding hundreds of customers to the franchise. It's a very good product and we're focused on extending the offer set. And so you would've seen since August us announce a whole series of new APEX offers things like APEX VMC, Tanzu support, APEX containers for OpenShift, APEX data storage services, target for the data protection backup, APEX high performance compute. And so we're not looking to force customers down any one of those three routes I described. But we are offering kind of choice and we'll continue to add to the portfolio of managed service. It's a very important part of our infrastructure strategy.

Shannon Cross:

How's the margin profile of an APEX contract or solution relative to going to more of a transactional sale? And I'm just wondering because I joke about, I don't think about my iPhone costing $1,200, which would, in theory you would never want to spend that amount of money on a device in your pocket, but I think about it $65 a month. So it's much easier for me them to upsell me because I think about it radically. Is that something that also carries through especially-

Chuck Whitten:

Yeah, haven't talked a lot about the margin profile, but you would imagine it's the similar sort of dynamics as a software company or your phone there where you look it is a higher margin lifetime value opportunity for us. It gives customers the financial flexibility to not deploy as much cash up front, but over time there is value in that flexibility that they're paid for and that's reflected in the margin.

Shannon Cross:

And switching over to sales, I'm just curious, how does Dell think about the channel now? Because over the years, and the same thing as some of your peers have done it, we love the channel, we want to go direct, we want, because obviously you give up margin, but you also get benefits from going to the channel because there's obviously a significant increase in reach. So what's your current thought on the best go-to-market strategy?

Chuck Whitten:

We're proud. We're proudly omnichannel is how I would say it. So if you look at, call it roughly $100 billion trailing 12 months, 50% is our direct sales force and 50% is the channel. And it's exactly what you say, the channel brings us reach, they cover geographies that we don't maybe don't cover as deeply. They bring us new customers and geographies where we both work together. And so when we do it right, it's additive and it's multiplicative, and that's kind of been the dynamic. We haven't really changed our channel strategy or posture regarding that. You are right that in pockets of our business, we will make more money when we sell direct. A PC business where we sell our services and we attach our peripherals is a very lucrative business for us, but we're very transparent with the channel on that as well. And so if they bring us new customers, they sell our services, it's a multiplicative opportunity. And so we have a really ... Look, we have a competitively advantaged, I think, go-to-market engine with 32,000 sales makers and over 200,000 channel partners. So we're, as I said, proudly omnichannel.

Shannon Cross:

Is there any way to enhance dell.com? And I'm just thinking in light of the current macro environment where costs are scrutinized heavily, to try to do more, don't you call them inside sales?

Chuck Whitten:

And the reality of it is both our physical sales makers. So we have many, many, many inside sales reps that cover extend, reach and can farm a customer environment versus our outside sales that are hunters. But dell.com's an incredibly important asset as is in our premier pages, which are pages that are set up for our individual enterprise customers to be able to order online. And so look, from a margin standpoint in our business, the more we can eliminate human touches throughout the process, whether that's a physical sales maker or that's the friction that comes with, "Now I need another server. Do I pick up the phone and call a rep or do I go onto my premier page?" Online modernization has been a big push of ours and it's contributing to our enhanced margin performance. Our sales makers love it too because there's nothing like having your customer buy while you sleep and it just sort of extends our productivity.

Shannon Cross:

So thinking about your product portfolio, and again with the cash situation right now, you're probably not itching to run, maybe you are, but itching to run out and make a big acquisition. But in theory, if this is a downturn, the potential is that some of the companies you might acquire their valuations go down. So maybe it's strike while the iron is hot or something. How are you thinking about acquisitions and are there areas in the portfolio that you think you could enhance either organically or inorganically?

Chuck Whitten:

Yeah, well look, we think M&A is part of any good growth strategy. And frankly I think it should be in all seasons, right, good markets, down markets, I think we have an evergreen M&A strategy. So we're always looking. We've said a few things about our M&A strategy. One is it should be strategic and it shouldn't surprise anybody, the places that we're looking. So we've talked about our aspirations in new or very related markets to our core business, like multi-cloud, the edge, telecommunications. Those are the types of spaces that you would imagine us needing to extend our capabilities.

Two, our principle objective is extending our innovation and talent agendas in those spaces. And then three, look, the reality is the circumstances around the EMC transaction as an example, big transformational, sizeable deals, it's pretty unique circumstances. So we're much more focused on these strategic talent and technology acquisitions in those spaces. You are right, obviously in the public markets right now there's been a reset in valuations. The spaces I'm describing are often in the private markets. Some of those are still stickier, but we're constantly looking and you'll see us being an acquirer in those spaces.

Shannon Cross:

Is there a way to think about the amount of software content that you bring to customers? Because I think one of the things that hardware companies sometimes get knocked by is that they show up with a box and nobody's, in my opinion, especially on the storage side with the margins you get, nobody's paying you that for a box. No, they're paying you that for everything you bring to the table. When you think about it internally at Dell, do you think about the software sort of separate, or how is it managed and how should we think about it from an outside perspective looking in?

Chuck Whitten:

Yeah, I think you're right. I think that modern infrastructure is software. And you look in our storage business, we command the margins because of the software assets that we have in the space. And you see some of our assets that are pure software and easy to understand and products like our software defined storage asset PowerFlex or our data protection assets or our thrusts in multi-cloud like Project Alpine, which is putting our file, block, and object storage software.

But internally of Dell, we tend to think of it, look these solutions, it's software and if I can contrast to a public cloud conversation, public cloud is providing infrastructure, physical hardware and software, we do the same, we do it on premise. And so I do think there's a fair nudge in your question of is there a way for us to maybe help investors understand a little bit more the rich software assets we have because they're so key to our multi-cloud ambitions and they're so key to how we're winning and storage. There is probably work to do there so that you don't have too many people think of it, “Hey, it's just a box.”

Shannon Cross:

Well, at one point HPE did that and then they ended up with autonomy. So there are some challenges with how you look at things, but I agree it could be helpful. One, just on our last question maybe is because I think it's important and I think it's also underappreciated, is can you talk about the Telco opportunity, the Dell scene?

Chuck Whitten:

Sure. We've had a large business in Telco for years, but principally with the IT departments of Telco because the network itself has been closed, and now as operators have logically said, "Hey, my business model requires me to spend maybe less on the network and start to adopt modern cloud-like open architecture." We're a natural player in that space. And whether it's open RAN or it's just the modernization of their network, they need industry standard cloud operating models, broaden that. We provide more open standard infrastructure than anybody.

So we've invested in a telecom business unit. Our goal is to drive incremental growth above what we do with sort of our existing business in Telco. And it's having a lot of success in those dialogues. You can go read our press of the many architectural wins that we've had with operators around the world that are looking to reduce the cost ultimately of their network. And so given our combination of assets in infrastructure and our global services layer, which is very important in bringing those components together. If you're going to go to an open network, we think we have a real play there. It'll take some time to play out, but it's an important investment as well.

Shannon Cross:

Great. Well, maybe just in the last minute or so, if you want to talk a little bit about what you're, I like to end things on a positive note, what you're most excited about now that you've joined Dell officially and looking forward in the next few years.

Chuck Whitten:

Yeah, look, I would just leave everybody with, we have an amazing opportunity as a company. We've performed exceptionally well in the last few years. Q3 was, we performed very, very well in a very difficult environment. We generated high levels of profitability, we gained share, we managed our cost, I think quickly and decisively given our advantage demand signal. So that's what we mean when we say this business is positioned to outperform in any market environment. I think it's a great time for investors to take a look at us. I think we have leadership positions in our core markets. I think we have a balance sheet that allows us to both invest and return capital to shareholders at an attractive rate. And I see lots of growth opportunities around the business. So no better time than right now to take a look at us.

Shannon Cross:

Great. Well thank you so much for joining us, and we'll keep watching.

Chuck Whitten:

Thank you.