TRANSCRIPT

DELL - Q3 2023 Dell Technologies Inc Earnings Call

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Fiscal Year 2023 Third Quarter Financial Results Conference Call for Dell Technologies, Inc. I'd like to inform all participants that this call is being recorded at the request of Dell Technologies. This broadcast is the copyrighted property of Dell Technologies Inc. Any rebroadcast of this information whole or part without prior written permission of Dell Technologies is prohibited.

I would now like to turn the call over to Rob Williams, Head of Investor Relations. Mr. Williams, you may begin.

Robert Williams - Dell Technologies Inc. - SVP of IR

Thanks, everyone, for joining us. With me today are Jeff Clarke, Chuck Whitten, Tom Sweet and Tyler Johnson. Our earnings materials are available on our IR website, and I encourage you to review our materials and presentation which includes additional content to complement our discussion this afternoon. Guidance will be covered on today's call.

During this call, unless otherwise indicated, all references to financial measures refer to non-GAAP financial measures, including non-GAAP revenue, gross margin, operating expenses, operating income, net income and diluted earnings per share. A reconciliation of these measures to their most directly comparable GAAP measures can be found in our web deck and our press release. Growth percentages refer to year-over-year change unless otherwise specified.

Statements made during this call that relate to future results and events are forward-looking statements based on current expectations. Actual results and events could differ materially from those projected due to a number of risks and uncertainties which are discussed in our web deck and our SEC filings. We assume no obligation to update our forward-looking statements.

Now I'll turn it over to Chuck.

Chuck Whitten - Dell Technologies Inc. - Co-COO

Thanks, Rob. We delivered very good results, including strong ISG revenue with record profitability and good CSG profitability despite the difficult demand environment that we highlighted in our last earnings call. The net of our disciplined execution was Q3 revenue of $24.7 billion, down 6% with record operating income of $2.4 billion and record diluted EPS of $2.30. ISG revenue was $9.6 billion, up 12%, while CSG was $13.8 billion, down 17%.

From a macro perspective, Q3 played out as we previewed last quarter. Soft underlying PC demand and slowing infrastructure demand. Though storage did hold up fairly well relative to servers with growth in multiple storage types, including high-end and PowerStore. Our Q3 performance underscores our strategic focus, the advantages of our model and our ability to deliver differentiated results in any market environment.

Our unique sales model provides direct, real-time feedback from customers of all sizes and across geographies and industries, which allows us to see the demand environment shift faster than the rest of the industry. And as the demand environment changed, we reacted quickly and decisively, which showed in our results. We took actions to reduce costs, decreasing our operating expense 3% sequentially in Q2 and another 6% sequentially in Q3.

We have now reduced quarterly operating expense by over $300 million since Q1. We reduced server backlog consistent with our Q2 commentary, and delivered strong profitability as our model allowed us to access component cost deflation faster than the rest of the industry. And we stayed focused on relative performance in the most profitable segments of the market. Despite some expected distortions in the PC market given elevated competitor backlog, we continue to gain commercial PC unit share in Q3 and have now gained share in 35 of the last 39 quarters. In ISG, we expect to extend our industry-leading share positions in servers and storage when Q3 IDC results are announced in December.

And we executed on all of the above without compromising our innovation agenda, with 30 infrastructure launches in the last 13 weeks, including 6 new Dell APEX offerings in strategic areas like multi-cloud, edge and subscription and as-a-Service. We're excited about the launch of Project Frontier, our initiative to deliver an edge operation software platform focused on unifying edge operations across infrastructure and applications for a broad set of industries.

And earlier today, we announced the availability of PowerFlex, our flagship software-defined storage solution, on AWS. With the cloud-first design point, PowerFlex on AWS is the first of Dell's industry-leading storage offerings available in the public cloud as part of Project Alpine. Our effort to bring our industry-leading storage software to public cloud to provide multi-cloud data mobility and simplify data management.

It will enable customers to use Dell storage software capabilities and APIs wherever their data resides, without the need for purpose-built or specialized public cloud infrastructure. Our new Project Alpine related SaaS offerings will add to our growing portfolio of APEX solutions, while enabling our customers to harness the power of multi-cloud.

Stepping back, the near-term market remains challenged and uncertain. On one hand, we are seeing some customers delay IT purchases. Other customers continue to move ahead with Dell given the criticality of technology to their long-term competitiveness and a growing need to drive near-term productivity through IT. The world continues to digitally transform. Data continues to grow exponentially, and customers continue to look to technology to drive their business forward no matter the economic climate.

As the market leader in commercial PCs and infrastructure, we are well positioned, whether a customer is seeking to drive growth, productivity and efficiencies or a combination. We're trusted advisers to our customers, and we have a business model that allows us to adjust quickly to meet their needs.

So we are very confident in our ability to adapt and deliver results despite the near-term uncertainty. Q3 was proof of our underlying advantages and ability to execute no matter the environment. As always, we'll continue to focus on what we can control, taking care of our customers, driving differentiated relative performance, delivering against our innovation agenda, managing our cost position, maintaining pricing discipline and building a unique and winning culture with our team.

This is the playbook that has served us well across multiple cycles and no matter the backdrop, we intend to accelerate our strategic position as we did in Q3.

Now I'll turn it over to Tom for the financials.

Thomas Sweet - Dell Technologies Inc. - Executive VP & CFO

Thanks, Chuck. I'm pleased with our Q3 P&L performance despite the tougher near-term demand environment. As Chuck mentioned, we highlighted the softening environment and slowing ISG demand in our Q2 earnings conversation and the third quarter generally played out as we expected, albeit with server demand velocity slowing a bit more than we anticipated. We continue to focus on executing our strategy to win in the consolidation and modernization of our core markets. And we have executed well over the last few years and again in Q3.

In ISG, we've grown our revenue for 7 consecutive quarters and have grown our revenue at a 3% CAGR since fiscal year '20. We have been consistent structural share gainers in servers where we are #1, gaining 530 basis points over the last 5 years in mainstream server revenue per IDC. In storage, we are bigger than 2 and 3 combined. And with our refreshed storage portfolio, we have added to our #1 position, gaining share over the last 2 quarters and anticipate gaining share in both storage as well as servers again this quarter when IDC results come out in December.

Our CSG business has grown at a 12% CAGR since fiscal year '20. As Chuck mentioned earlier, we have gained commercial PC unit share in 35 of the last 39 quarters, including Q3.

Turning to our Q3 results. We delivered revenue of $24.7 billion, down 6% with strong ISG performance, particularly in servers. We reduced total backlog by $1.2 billion sequentially during the quarter with CSG backlog now in a more normal range and ISG backlog slightly elevated year-on-year but substantially reduced from the beginning of the quarter.

Profitability was strong in Q3. Gross margin was $5.9 billion, up 2% and 23.7% of revenue. Gross margin percentage was up 2 points, primarily due to a favorable mix shift to ISG and a decrease in our cost of goods sold due to certain components turning deflationary along with declining logistics costs. FX remained a headwind and impacted revenue by approximately 420 basis points. Q3 operating expense was $3.5 billion, down 8% and 14.1% of revenue as we slowed hiring and reduced discretionary costs given the current macro environment.

As a result, operating income was a record $2.4 billion, up 22% and 9.6% of revenue. Our year-to-date tax rate decreased to 18.2%, primarily due to geographic mix of income. Q3 net income was $1.7 billion, up 30%, primarily driven by growth in operating income and a decline in interest expense due to our lower debt balances. Fully diluted earnings per share was a record $2.30, up 39%, with diluted share count decreasing sequentially to 743 million shares as a result of share repurchases in Q3.

Our recurring revenue is approximately $5.4 billion a quarter, up 11%. Our remaining performance obligations, or RPO, is approximately $39 billion, down year-over-year due to a decline in backlog, partially offset by an increase in deferred revenue.

Turning to our business units. In ISG, Q3 revenue was $9.6 billion, up 12% driven by a reduction in our server backlog, consistent with our Q2 call commentary.

Servers and networking revenue was $5.2 billion, up 14%, and storage revenue was $4.4 billion, up 11%. As mentioned, we did see softening unit demand in servers, somewhat offset by higher average selling prices, given richer configurations driven by customers running more complex workloads. ISG operating income came in at a record $1.4 billion or 14.3% of revenue which was up 390 basis points as we benefited from scale with lower operating expenses and pricing discipline.

Our Client Solutions Group revenue was down 17% to $13.8 billion, primarily due to underlying softness in both commercial and consumer demand. Commercial revenue was $10.7 billion, down 13% and consumer revenue was $3 billion, down 29%. Average selling prices trended higher in both commercial and consumer as customers bought PCs with richer configurations. CSG operating income was $1.1 billion, down 7% primarily due to scaling partially offset by stronger gross margin percentage and lower operating expenses.

CSG operating income was 7.7% of revenue. Dell Financial Services originations were $2.3 billion, up 17% with strength across geographies and DFS ended the quarter with $13.8 billion in assets. We have historically seen stronger originations and more recently, an increasing interest in subscription models as the macro environment slows.

Turning to our cash flow and balance sheet. Our cash flow from operations was approximately $400 million in Q3 and is $3.9 billion on a trailing 12-month basis. Q3 cash flow was helped by profitability but offset by the sequential revenue decline in the P&L and a use in working capital. Within working capital, inventory was up sequentially as we strategically accelerated purchases of some key components as we continue to navigate through supply chain dynamics. Improving working capital efficiency and reducing inventory remains a priority.

Our core debt balance is $16.2 billion, and our core leverage ratio is 1.6x. We ended the quarter with $6.5 billion in cash and investments, down $600 million sequentially, principally due to $800 million in capital returns.

Turning to capital allocation. We repurchased 16.3 million shares of stock in Q3 for $609 million and paid $238 million in dividends. In addition to our $1 billion annual dividend, since the beginning of our current share repurchase program, we have bought back 70.3 million shares for $3.36 billion. Going forward, we will continue our balanced capital allocation approach, repurchasing shares programmatically to manage dilution while maintaining flexibility to be opportunistic.

Turning to guidance. Considering the demand environment, we expect Q4 revenue between $23 billion and $24 billion, down 16% at the midpoint with ISG roughly flat. Similar to Q3, currency continues to be a headwind for us. We are expecting a roughly 500 basis point impact to Q4 revenue. We continue to be focused on managing costs. However, we do expect to see a roughly $150 million OpEx increase sequentially given the extra week in our fiscal Q4.

We expect our interest and other expense to be up $60 million sequentially driven by interest rate volatility and the impact on our derivatives portfolio. For our non-GAAP tax rate, you should assume 22% at the midpoint, which reflects a 19% plus or minus 100 basis point rate for the full year. We expect our diluted share count to be roughly 730 million to 735 million shares. Netting this out, we expect diluted earnings per share in the range of $1.50 to $1.80, down 4% at the midpoint.

I recognize that many of you have questions about our view on fiscal year '24. It's still early in our annual planning process. However, I'll frame our current thinking. We expect ongoing global macroeconomic factors, including slowing economic growth, inflation, rising interest rates and currency pressure to weigh on our customers. And as a result, their IT spending intentions even as they continue to digitize their businesses. These dynamics are creating a broader range of financial outcomes for our upcoming fiscal year, particularly as we think about the second half of the year. With what we know today, it's likely next year's revenue is below historical sequentials using our Q4 guidance as a starting point.

In closing, we delivered strong third quarter financial results. We have strong conviction in the growth of our TAM over the long term even though some customers have paused purchases in the near term, and we are committed to delivering our value creation framework with a revenue CAGR of 3% to 4%, a diluted earnings per share CAGR of 6% plus and a net income to adjusted free cash flow conversion of 100% or better.

Since fiscal year '20, our revenue has grown at an 8% CAGR, our diluted earnings per share has grown at nearly a 20% CAGR, and we have exceeded our net income to adjusted free cash flow target in each of the last 3 fiscal years. We have also committed to return 40% to 60% of our adjusted free cash flow to our shareholders over time and have returned $4.1 billion of capital to our shareholders over the last 12 months through share repurchase and dividends.

We will continue to be disciplined in how we are managing the business in our financial posture in this complex macro environment, focusing on what we can control and helping our customers along their digital journey.

Now I'll turn it back to Rob to begin Q&A.

Robert Williams - Dell Technologies Inc. - SVP of IR

Thanks, Tom. Let's get to Q&A. We ask that each participant ask 1 question to allow us to get to as many of you as possible. Let's go to the first question.

QUESTIONS AND ANSWERS

Operator

We'll take our first question from Krish Sankar with Cowen and Company.

Krish Sankar - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

Chuck, I'm just kind of curious, you mentioned about how the IT spending is softening. What do you see across the ecosystem? Is it across all enterprises, the large and smaller ones? And within that, where do you think they're focusing their budgets on right now? Is it more server, storage or software? Just kind of curious, any thoughts you can give on the IT spending environment you’re seeing.

Chuck Whitten - Dell Technologies Inc. - Co-COO

Yes. Thanks, Krish. Let me give you a little bit of the texture that we're seeing. But maybe let me start by just highlighting, look, we executed very well in what was a very dynamic environment. As we've highlighted, our principal objective in this environment is to deliver relative performance and share gain. And in Q3, we did that across client server and storage, and we delivered very good profitability.

So while we're not going to get into specific demand numbers today, let me offer some texture on the environment that we're seeing. First, I would just say that the CSG demand environment remains challenged with, as you saw in our results, consumer weaker than commercial. We saw slowing server growth. As Tom highlighted in our prepared remarks, it was probably a little bit worse than we anticipated at the time of our Q2 earnings call. And so as we said, Q3 server revenue growth of 14% was aided by server backlog reduction and storage fared better.

It's ultimately not immune to the broader dynamics we're seeing across customers, but we saw growth across multiple storage categories, including the high-end HCI and PowerStore. To your direct question about texture underpinning that, those dynamics were largely consistent across geographies, we'd say, verticals as well and customer size. There's probably a couple of exceptions we would call out. One would be China, which had a much more pronounced weakness last quarter.

And we would highlight the energy sector, the U.S. government sector and then medium business generally globally as performing better relative to the rest of the business. And the customer feedback is very similar to what we described in Q2, very cautious and deliberate behavior in the face of what's a lot of economic -- macroeconomic dynamics out there. So we're hearing reassessment of budgets, reprioritization, excuse me, of spending and customers buying effectively for just their immediate needs. So net, I would say Q3 was a continuation of the trends that we called out during our Q2 earnings call.

Operator

We'll take our next question from David Vogt with UBS.

David Vogt - UBS Investment Bank, Research Division - Analyst

Tom, maybe this is for you. Can you kind of elaborate on your earlier remarks about the framework for '24. Just to clarify, when you talk about -- obviously, there's a lot of moving pieces, but how do you think about the historical sequential moves as we move through the year. So are you trying to communicate that we basically start with Q4 and then take sort of a normal sequential pattern over the last, let's say, 2 to 3 years and sort of maybe haircut that a little bit given the uncertainty? Just trying to maybe level set since my line dropped a little bit.

Thomas Sweet - Dell Technologies Inc. - Executive VP & CFO

David, happy to sort of elaborate on that. Obviously, as we look at the environment, it's pretty early in our planning process from a fiscal year '24 perspective. Clearly, the landscape and the dynamics are complex, and there's a high degree of complexity out there, whether it's around inflation or interest rates, what's going on with FX, global growth in general, supply chain, geopolitical. I could probably go on, but you get the point that at this point, there's as we look at it, there's a pretty wide range of financial outcomes depending upon how some of these things move and change on us. And in particular, I would say the back half of next year continues to be -- has a fair amount of complexity.

So Chuck mentioned that we do see customers with a bit of cautiousness in their spend right now. I think that's pretty evident. And so that said, we're going to focus on what we can control, meaning we'll focus on ensuring we help our customers as well as ensuring we manage the P&L properly, both -- and be tight on both spending and customer satisfaction.

And just a reminder, I would highlight that from a spend perspective, we've been focused on spend now for a number of quarters as we have restrained hiring and put other cost control measures in place. But having said all of that, what I was trying to elaborate while I don't want to get into exactly what next year looks like because we're still working our way through it. We do think it's going to -- it's got some complexity and some challenges to it.

And as a result of that, if you took sort of the midpoint of our guide and then ran historic -- normal historical sequential, say, over a couple of -- 2-year historicals and maybe haircut those a bit, I think you're going to be in the ballpark of where what our current thinking is, recognizing that's going to continue to evolve and change over the coming months.

Maybe the other data point to help you triangulate on that is if you look at P&L revenue growth in the back half of fiscal '23. So obviously, the minus 6 that we just printed for Q3, at the midpoint, minus 16 of our Q4 guide sort of points to a minus 10, minus 11 sort of growth rate, and that's probably something you ought to think about as you do that math.

Operator

We'll take our next question from Tim Long with Barclays.

Timothy Patrick Long - Barclays Bank PLC, Research Division - MD and Senior Technology Hardware & Networking Analyst

I was hoping to dig a little deeper into CSG. Obviously, in the guide, that sounds like it's a little bit more challenged of the market. I think you mentioned ASPs were up in this Q3. So can you talk a little bit about kind of where we are with channel inventory in commercial and consumer?

What you see going on in the pricing and what impact that will have in margin? And maybe if you could just throw in what's going on with your backlog. I'm sure it's being worked down as well. It's probably a multiple parter there, but I think you get the gist.

Chuck Whitten - Dell Technologies Inc. - Co-COO

Yes, Tim, there's a lot in there. Let me start to unpack it and we'll probably double or triple team this one. So look, obviously, it's a challenging PC market backdrop. So maybe I'll just start with our current internal estimates for this year, which I think we shared on our last Q2 call of sort of 280 million to 290 million industry units. That's still our estimate as we go into Q4. And that implies sort of a mid double-digit decline in units year-over-year.

And I think that would be the single largest percentage decline in recent history. You'd have to go back to 2015 to see something sharper. So that's the reality of the backdrop today. As I highlighted, commercial is holding up better than consumer, and that's clearly consistent with long-term industry trends. Commercial PCs, excluding Chrome, tend to be the more durable portion of the market along with premium consumer and gaming, and that's where we've been focused.

And so that's the dynamic that we see right now. As expected in that environment, from what we've seen, channel inventories remain elevated. We see promotional activity to sort of move units through distribution in particular. And as I said, customers are sort of waiting for -- to purchase for their immediate needs in this environment. In terms of pricing, you mentioned ASPs.

Look, pricing has remained relatively stable across our businesses. If I stay on PCs for a moment, there's a number of factors. Clearly, in this demand environment, we've seen a more competitive pricing environment. Consumer was the first clearly to see that pressure a couple of quarters ago, and it remains very competitive, and we saw the pricing environment get even more aggressive as the quarter progressed.

I would call commercial also as very, very competitive right now given the slowdown we were describing. We've seen more aggressive pricing, particularly in the largest accounts as the quarter progressed. And so that's the backdrop, as you can imagine, from a supply chain standpoint, supply and demand are -- where they were out of balance last year, we're now on more standard lead times across the portfolio, and we're really in a position where what we sell is what we ship in any given quarter, and that's the dynamic in CSG.

Operator

We'll take our next question from Samik Chatterjee with JPMorgan.

Samik Chatterjee - JPMorgan Chase & Co, Research Division - Analyst

Yes. No, I guess if I can just talk about the sort of initial thoughts that you provided on fiscal '24 and understand some of the challenges and headwinds on the top line. But -- maybe if you can talk about what you're thinking in terms of the sustainability of the gross margin, particularly I'm assuming some of the mix impact carries over on ISG versus CSG. And you've had a couple of quarters of sequential decline in OpEx here. But as you sort of look forward, how are you trying to align your cost structure to that sort of demand environment that you're thinking of? And sort of what are the puts and takes when we think about the rest of the P&L in fiscal '24?

Thomas Sweet - Dell Technologies Inc. - Executive VP & CFO

Yes. Samik, look, I don't want to get into talking through every line item. I mean, we gave you some early thinking just so you guys sort of think your way through what the P&L dynamics at a top line might look like. I'd highlight a couple of things though, right? So first, as it relates to gross margin stability and our OpEx, look, we'll work our way through what margin dynamics will look like. We do expect right now that component costs are deflationary in the first half of next year with what we know today.

We do think that the back half potentially may change just given some of the supply-demand balances that are out there as we work our way through the year. Obviously, in a declining demand environment, if there is a little bit of ASP pressure, which we would expect that we might see next year. However, I do think that if you look at our mix of products and where we're focused on end markets, we've got, whether it's due to configuration or attach rates in the client space or the fact that our servers that we're shipping have a thicker content rate from a memory perspective, those should all be helpful as well.

From an OpEx per -- so margins, I think we'll have to work our way through. OpEx, look, I think we've taken cost actions that have demonstrated the fact that we can control OpEx. And if anything, that we're very much focused on how do you manage your way through a complex environment like this, we will adjust our spend targets and our cost envelopes as appropriate to manage the P&L. So I feel pretty confident in our ability to do so. The actions we've taken already you can see them in the P&L, and we'll continue to work our way through that. So look, I think it's early to start talking full P&L at this point. Again, I just wanted to make sure you guys have some context around top line as we see it right now.

Operator

We'll take our next question from Amit Daryanani with Evercore.

Amit Jawaharlaz Daryanani - Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst

I guess I was really hoping you could talk a bit more about the ISG side and the performance this quarter. Is there a way to understand and look at ISG in aggregate or maybe even server and storage, how much of this growth is backlog versus end demand? And it sounds like the end demand is weaker, so I was wondering if there was a way to slice those two buckets up. And then Tom, I think you mentioned the OpEx headwind or the OpEx impact from the extra week in Q4. I could have missed this, but could you just tell us what the revenue benefit in Q4 as well from extra week.

Chuck Whitten - Dell Technologies Inc. - Co-COO

Yes. Amit, I mean, maybe I'll jump in on the business. I'm not sure I have a ton to add to our prior answers other than to say, look, the server business, we saw slowing server growth. We had hinted at that -- not even hinted at that, stated that in Q2 and had anticipated coming into the quarter, I would say, look, it worsened over the course of the quarter vis-a-vis our Q2 earnings call.

And therefore, our server revenue growth of 14% on the P&L was aided by server backlog reduction. And we would characterize server backlog is now roughly in its normal range. Storage is a bit of a different story. It fared better. We saw growth across multiple storage categories, high-end HCI, PowerStore, I would say storage backlog remains somewhat elevated relative to historical norms given the larger business we're in. And so a little bit of different dynamics across server and storage, but all in all, a continuation of the trends that we saw in Q2.

Thomas Sweet - Dell Technologies Inc. - Executive VP & CFO

Yes. As it relates to Q4, there is an extra week there given the dynamics of our fiscal year. The any impact of revenue/margin, and the results are already -- we've already embedded that in our guide. Obviously, if you think about an extra week, there is some level of incremental transactional demand that you get from some of our more transactional businesses, but a big majority of our business is also project and bid based, which doesn't really get impacted by an extra week end of quarter. So our guide develops all of those above.

Operator

We'll take our next question from Aaron Rakers with Wells Fargo.

Aaron Christopher Rakers - Wells Fargo Securities, LLC, Research Division - MD of IT Hardware & Networking Equipment and Senior Equity Analyst

I want to go back a little bit to the margin profile and maybe understand the dynamics of deflationary component costs. And how quickly you're being able to capture that in your server business? I guess in the context of just thinking about the pressure on the model, how do we think about the sustainability of that operating margin given very strong performance this last quarter in terms of ISG in that context.

Thomas Sweet - Dell Technologies Inc. - Executive VP & CFO

Aaron, it's -- let me sort of try and unpack that for you a bit, right? So look, Chuck has already highlighted what we saw from a pricing environment perspective. Obviously, we talked about the fact in Q2 -- in our Q2 call that to the extent that we saw that we're in a component cost deflationary environment, we tend to do reasonably well from a margin perspective, given that we don't move pricing as much as costs come down or the pacing of that is different.

And I think that's what we saw this quarter. So we had good -- lower input costs from component costs as well as logistics costs. We obviously priced for FX and some of the other dynamics that we saw in the environment. As a result of that, given the configuration in the amount of memory and storage we're putting on the servers particularly led to some better-than-anticipated margins, I would say. And so our ability to hold on to that -- over time, you obviously have to adjust pricing for some of those market commodities. But again, that's only one element of the pricing stack and you get into things like mix and configuration as other impacts. I don't know if Jeff may add any...

Jeffrey Clarke - Dell Technologies Inc. - Co-COO & Vice Chairman

Maybe to add to that back to our model and inventory. We have a lower inventory model. One of the benefits of how we run the company since beginning. It gave us availability to the lower cost component, I think, earlier than most. Our supply chain has executed well through this time. We had fewer mismatch sets. So we're able to convert the demand shipments and the backlog shipments throughout the quarter. And as a result of that, we were able also to take advantage, as Tom said, lower freight rates, lower expedites, lower supplier premiums, and we've obviously benefited from that throughout the quarter.

Operator

We'll take our next question from Sidney Ho with Deutsche Bank.

Sidney Ho - Deutsche Bank AG, Research Division - Director & Senior Analyst

My question is on cash flow. So I noticed your first 3 quarters of the year in aggregate, free cash flow was negative. And you talked about building some strategic inventory in the last quarter. How do you think about Q4, and by definition, for the rest of the year? And as we think through next year, do you expect cash flow to exceed your net income? I guess I am asking how long do you think it would take working capital to get back to normalized levels?

Tyler Johnson - Dell Technologies Inc. - Senior VP & Treasurer

Yes, this is Tyler. I'll take that one. So look, I think maybe just to start, if you think about the last couple of years, right, cash has been really strong, right? So we were seeing that build given that negative cash conversion cycle, and we obviously benefit from that. I think what we're seeing now is the opposite of that, right?

And there's 2 things happening, and you talked about it, right? So we've got the contraction in the P&L, which is impacting cash and then working capital. And our intent, obviously, is to drive those working capital balances down, but we also don't want to miss opportunities and you saw us take advantage of that this quarter, which impacted cash. Now as I'm thinking into Q4, and I'm thinking it next year and recognize we don't provide guidance, I think you have to keep that in context that, one, Tom has talked about that there will be some pressure in the P&L, and that will impact cash.

But at the same time, we do have opportunities in working capital, and it's quite substantial, right? So we'll be focused on driving that down. And obviously, that's something we know how to do, and we'll be smart about it. But that's how I'm thinking about it.

Thomas Sweet - Dell Technologies Inc. - Executive VP & CFO

Yes. And then, Tyler, I would -- but we historically do generate cash and Q4 tends to be a seasonally stronger quarter for us. Now we'll have to work our way through this quarter. But look, I'm confident in the long-term model in terms of cash generation. It's -- obviously, when we're on a negative working capital or negative cash conversion cycle, when you get sequential revenue decline in the P&L, you're going to use cash. And that's what we're seeing.

But the team is managing its way through it. We've got work to do in inventory. Pleased with what we're doing in receivables in terms of what that looks like in terms of the aging profile, collections, our ability to manage our way through it. So it's just one of we're in a cycle where we're just going to have to work our way through it. But long term, I believe the model is intact.

Operator

We'll take our next question from Erik Woodring with Morgan Stanley.

Erik William Richard Woodring - Morgan Stanley, Research Division - Research Associate

Maybe just if we unpack the fiscal fourth quarter, the January quarter guide for a bit. Would just love to know maybe if you could double click on -- or elaborate on your comments on kind of pricing versus volume, whether we should think of both of those as a headwind or whether some of the richer configs helps to offset some of the discounting that you mentioned to allow pricing to still grow over a year. So just really pricing versus volume comments for the January quarter.

Thomas Sweet - Dell Technologies Inc. - Executive VP & CFO

Yes. Look, as we think about the guide, right, so '23 to '24, '23 to '25, obviously, at the midpoint of minus 16%. We essentially say that we expect ISG to be roughly flat. That sort of implies that the client business or CSG is sort of in the negative -- minus mid-20 sort of year-over-year growth. Look, as we work our way through whether units versus ASPs, I'm not going to get into a lot of detail, but I want you to think a little -- if you think about margin dynamics in Q4 for a second, so you've got some seasonal dynamics that typically happen in our Q4.

One, tends to be a stronger storage quarter for us given the corporate budget cycle, the calendar year corporate budget cycle that tends to be a positive in terms of margin dynamics. The flip side of that is you get into the holiday season. Traditionally, that has been a bit stronger from a consumer PC perspective, which has put, as you might imagine, shifts the mix a little bit and put some a little bit of downward pressure on margin, coupled with -- we highlighted the fact that we did see some incremental commercial PC discounting in Q3, particularly in the third month of the quarter.

And obviously, we have -- there are elevated inventory levels in the channel. So we put it all together and quite frankly, we sort of think about margins from Q3 to Q4 at an aggregate level as being roughly flat. And then you couple that with the OpEx dynamic that I'm talking, we highlighted that sort of gets the, quite frankly, the P&L walk as you think about it.

Operator

We'll take our next question from Steven Fox, Fox Advisors.

Steven Bryant Fox - Fox Advisors LLC - Founder & CEO

I had a margin question also. I was just curious, when we look at sort of the big beat in margin -- gross margins this quarter, you mentioned a lot of different dynamics, including things that seem under your control a little bit, like configuration and content attach rates. So how much were you able to manage the margins up versus just circumstance? And how much can we sort of think about Dell going forward in the tough environment, being able to manage the gross margins a little bit better?

Chuck Whitten - Dell Technologies Inc. - Co-COO

Yes, let me start. I think, look, Q3 highlights, I think it's both the advantages of our model and very good execution in quarters. So look, foundationally, if you unpack Q3, clearly, we saw higher ISG mix. And as we've said, a relatively stable pricing dynamic. And that pricing dynamic is a combination on the PC side, richer configurations and a more favorable mix of product along with higher attach rates, helping offset PC unit declines.

And then on the server side of the business, higher content rates, so I think memory, SSDs, richer GPUs, offsetting the unit pressure. So I think that's just foundationally. But I think the real margin story is what we were talking about a couple of questions ago, with Q3 being deflationary and our lower inventory model, it allows us to access component deflation faster than the industry.

And then when you couple that with our ability to see the demand signal quickly and react, we were able to lower OpEx as we put in the prudent cost controls that Tom described. So those were the puts and takes across Q3. A lot of that is in our control. Some of that is the advantages of our model in this environment.

Jeffrey Clarke - Dell Technologies Inc. - Co-COO & Vice Chairman

Maybe to add to that, another view of inventory is we don't have excess channel inventory. We're not in a position of having to discount that, not in a position to have to promo that. We're not in a position where you have to go chase volume. We have a conscious strategy in the high-price band (inaudible) consumer and the focus on commercial. That gives us historically, and I think we're seeing it today, an advantage in the market. So we're not having to respond to that discounting in promotional activity to burn down excess inventory. Plus by the fact that we have lower inventory, just as Chuck said, we were able to take advantage of lower input cost, component costs throughout the quarter. Coupled with that, like Chuck -- maybe I wasn't clear earlier, but I think it's worth emphasizing again, the logistics costs have come down. As supply now is ahead of demand, we're able to put things on the ocean. We don't have to expedite as much. We're not using as much expedited air freight. Those all go into our input cost equation, which obviously helped us in the bottom line and the performance of this quarter.

Operator

We'll take our next question from Wamsi Mohan with Bank of America.

Ruplu Bhattacharya - BofA Securities, Research Division - Director & Research Analyst

It's actually Ruplu filling in for Wamsi today. Can you talk about the component shortage environment that is still affecting maybe ISG? And if anything, on the CSG side. Did you have any revenue that you left on the table because you weren't able to get all the parts. And then just on ISG, you talked about backlog reducing this quarter. How far would you say that we are out from backlog normalizing? And do you think you'll get any support on that on the server side? Or is it -- or the backlog is all on the storage right now?

Jeffrey Clarke - Dell Technologies Inc. - Co-COO & Vice Chairman

Sure. Let me try to break that down -- those multiple questions and at least as I think about supply and where some of the shortages are. If I look at the CSG business, again, largely a handful of minor exceptions, supply is ahead of demand across consumer PCs, commercial PCs, displays, docs to the point that we're now able to readjust our freight networks to take advantage of that. We're in a good position. Servers, we had -- as the team mentioned, we talked about backlog and backlog reduction. I tend to think of it -- since you asked about supply where are the hot spots in supply. They tend to be in power supplies. They tend to be in the power ICs and high-performance NICs. Those are still constraints in the marketplace today.

I think we weathered the storm quite well throughout this period of time and particularly in Q3 and allowed us to maximize server shipments. In storage, the shortages would be in these custom ASIC parts. So think of it as FPGA, CPLDs, those types of devices. The best way we translate this to our customers is in the form of lead time. I don't think -- I can't remember the last time I was in front of you all and said the PC product line is essentially on standard lead time.

It's been a long path through this COVID supply chain challenge time to be able to say our PC product line is on standard lead time. Our server product line, a large percentage of that is on standard lead time, and it will improve throughout the quarter as will storage. So if I think about it in terms of specific backlog, we are at normal backlog in PCs. I think we're at normal to near normal backlogs in servers and a slightly elevated backlog in storage. I think that answered all 3 of your questions.

Operator

We'll take our next question from Simon Leopold with Raymond James.

Simon Matthew Leopold - Raymond James & Associates, Inc., Research Division - Research Analyst

I wanted to see if you could maybe talk to the general idea of why storage would or would not be correlated to servers in the sense that you're seeing slowing demand in your server business, should that signal coming or threats to the storage business? Or should we think of them as trending differently? And if so, why?

Chuck Whitten - Dell Technologies Inc. - Co-COO

Yes. Look, Simon, I would say, look, we would never argue that storage is immune to the broader IT spending dynamics that are out there. But we would say it's from where we sit right now, it's held up better in our Q3. I think you're right, historically, there's been a correlation, but it tends to have less amplitude than, say, our commercial PC market or the server market.

Clearly, right now, data is exploding. The world needs more storage. And so when we flash forward to what's implicit in our guidance, we're anticipating a seasonally strong storage quarter in Q4. And so I think why you're right, historically, there's been a correlation between our server and storage business at least from where we sit right now, we're still seeing strength in the storage market.

Jeffrey Clarke - Dell Technologies Inc. - Co-COO & Vice Chairman

And maybe one quick point to add is, and we participate in the entire storage market, primary storage, data protection, recently the cyber resilience side as well as the HCI side. That broad portfolio, I think, helps us weather these cyclical changes more than others.

Operator

We'll take our next question from Toni Sacconaghi with Bernstein.

A.M. Sacconaghi - Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst

Yes. I'm just trying to square how much worse incrementally and sequentially, you think demand may get in fiscal Q4. So when I kind of look at your numbers, typically, you're up from Q3 to Q4 by 5-plus percent. So let's say, $1 billion. An extra week, we're probably at a minimum of 5%. I get -- I know you have contractual business, but you have an extra week to deliver those on those contracts.

So that's up another 5%, that's $2-plus billion. So normal seasonality, you'd be up $2-plus billion and you're guiding basically to be down $1 billion. So it's a $3 billion delta versus normal seasonality. So I guess a couple of questions. Does that imply that you see demand getting incrementally worse? And are you anticipating any backlog drawdown? I get it was $1.2 billion in the quarter, but that doesn't explain the $3 billion delta versus normal adjusting for the extra week. So are you expecting any backlog drawdown in Q4? And how elevated in dollar terms is the storage backlog relative to where server was entering Q3?

Thomas Sweet - Dell Technologies Inc. - Executive VP & CFO

Toni, let me try and answer some of those questions anyway. So as it relates to Q4, look, I think as we think about clearly, we're projecting that the business continues to soften, right? I mean I think that's pretty apparent given the fact that I'm telling you now that we expect PC revenue to be sort of in the mid negative growth -- mid-20s year-over-year negative growth.

And I'm expecting client -- or I'm sorry, ISG to be roughly flat versus where they were this quarter. So the business is softening. I think we'll manage our way through that like we always do. As it relates to the 14th week, there is a little bit of extra transactional demand in there. It's not that significant. So I haven't done the math on your $3 billion or your -- that 5% comment. But look, what we're trying to give you a point of view on is that we think demand does soften, right? And if you think about our guide for next year, that's sort of follows from there.

As it relates to backlog, look, we don't forecast what happens with backlog in terms of how we're going to talk to the Street about it. But we've just talked about the fact that in general, backlog is back in normal ranges. Yes, in storage is slightly elevated. So if there's any opportunity, it would be there, but that's very much going to be dependent upon linearity of the quarter and how the storage orders come in, which has always been an interesting dynamic with the storage business for us. What we've told you is our best point of view at this point in time, and we'll continue to manage the business tightly as a result. I don't know if Jeff or Chuck, you'd add anything to that.

Jeffrey Clarke - Dell Technologies Inc. - Co-COO & Vice Chairman

Well, I think it lies in the PC side. I just did a quick look in our web deck. Last Q3, we did $16.6 billion of CSG revenue. This Q3, it's $13.8 billion there probably lies the..

A.M. Sacconaghi - Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst

Right. I think the only question I was -- explicitly, as you commented about service weakening during the quarter. You didn't really comment that PCs were weakening throughout the quarter. And I'm wondering whether that was indeed the case because if it wasn't, it's not really clear why the guidance is where the guidance is, unless you're expecting real changes in ASPs.

Thomas Sweet - Dell Technologies Inc. - Executive VP & CFO

Yes. Look, I think we saw -- as you think back to our Q2 commentary, what we talked about the fact that we saw PCs -- consumer PCs have been soft, and we saw commercial PCs weakened. So I think that's pretty self-explanatory.

Operator

We'll take our next question from Shannon Cross with Credit Suisse.

Shannon Siemsen Cross - Crédit Suisse AG, Research Division - Research Analyst

Tom or Chuck, I not sure who mentioned it. I wanted to go back to one of the comments that was made, which is that you're seeing increasing interest in subscription models. I don't know if you can talk a bit about what customer bases are interested in them. How we should think about, I know they'll have a little bit of a dampening impact to revenue, but obviously locking in recurring revenue. So maybe if you can just discuss a bit of what you're hearing from customers.

Chuck Whitten - Dell Technologies Inc. - Co-COO

Yes. Thanks, Shannon. It's Chuck. I'll start. Look, it's -- that's been our APEX business, which in Q2, we highlighted that we sort of hit the $1 billion milestone and side growing at a continued healthy rate and adding new customers. We've been consistent that we're going to be thoughtful about how we discuss progress there.

We're not -- certainly not going to provide sort of quarter-to-quarter updates. And so we can share metrics that can be traced clearly back to the P&L. But what I would tell you is interest remains very high in our subscription offers. We saw again triple-digit customer growth and healthy ARR growth in the quarter. And we continue to invest in the portfolio and our web deck as a whole series of new APEX offers that we've released since we last spoke in August.

We tend to see broad-based interest. Right now, it does tend to be concentrated at some of the larger companies in the medium-sized businesses in the world, but we're getting a lot of interest in conversations from customers as they try to navigate this macro environment as you would imagine. It's not sizable enough relative to our $100 billion trailing 12-month business to sort of go much more beyond that. We are getting a lot of customer interest.

Shannon Siemsen Cross - Crédit Suisse AG, Research Division - Research Analyst

Any products -- sorry, go ahead.

Jeffrey Clarke - Dell Technologies Inc. - Co-COO & Vice Chairman

I'm sorry, Shannon, I was going to add the new backup target service that we just announced, it's a pretty exciting offer. What we've done around expanding our geographic capability, our channel capability and our customer managed option capability around ADSS, I think, is another extension that we can continue to grow on. And then the 2 as-a-Service offers that we've extended. One, the Red Hat offer that we announced back in September.

And then secondly, the new one, which is the APEX High Performance Computing service, I think, is another opportunity for us to grow. And I can tell you the pipeline is full of continue to do APEX offers.

Robert Williams - Dell Technologies Inc. - SVP of IR

Keith, we'll take 1 last question, and then we'll turn it back over to Chuck for closing comments.

Operator

We'll take our final question from Jim Suva with Citigroup.

James Dickey Suva - Citigroup Inc., Research Division - MD & Research Analyst

And I actually only have one question and that's on your inventories. While they were up and you talked about a deflationary environment for the need to secure some pretty key components which is understandable. Can you talk to us about when you think you'll actually kind of renormalize inventory and working capital? Or is it just better simply to hold more because with the deflationary environment, you just kind of have to wonder here, but I understand there's shortages.

Thomas Sweet - Dell Technologies Inc. - Executive VP & CFO

Yes. Jim, look, I mean it is my goal, and I think the goal of all of us here that we need to manage inventories down. We built it over the last couple of years given the supply chain dynamics going through the pandemic. In a deflationary environment, you clearly want to hold less inventory. And so I'm not going to give you an exact time line on where we -- how this thing sort of unfolds. But I think absent the strategic buys we did this quarter, the inventory actually came down quite nicely.

The strategic buys we did made economic sense. And so we -- that was the whole point behind that. So I do think it's going to be a few more quarters as we continue to normalize inventory. And then we'll have to evaluate this as we go in terms of what's the right level, given the supply chain dynamics. And so more to come on that. But in the meantime, over the next few number of quarters, we're pretty focused on pushing inventory down from a working capital perspective.

Chuck Whitten - Dell Technologies Inc. - Co-COO

Thanks for that, Jim. Before we end the call, I'm going to leave you with a few final thoughts on behalf of the team, and then we'll wrap. Look, we delivered strong performance over the last few years, and we delivered again in Q3. As we discussed today, Q3 highlights the advantages of our model. We see changes in the market first, and we react and position the business to outperform. So in Q3, we took appropriate cost action. We drove share gain. We delivered very good profitability. We drove our innovation agenda forward and we delivered against our capital return commitments.

And that's what we mean when we say that we can deliver differentiated results in any market environment. We do expect the demand environment to be challenging in the near term. But the long-term trends remain very much in our favor. And importantly, we have a seasoned leadership team led by Michael, Jeff and Tom, who have a strong track record of delivering across these challenging economic cycles. So we're going to stay focused on what we can control, and we remain committed to delivering differentiated results for our stakeholders as we did in Q3. So with that, we appreciate everybody joining us today, and look forward to seeing you soon.

Operator

Ladies and gentlemen, this concludes today's conference call. We appreciate your participation. You may now disconnect at this time.
