# TRANSCRIPT

DELL - Q3 2024 Dell Technologies Inc Earnings Call

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## CORPORATE PARTICIPANTS

**Jeffrey W. Clarke** *Dell Technologies Inc. - COO & Vice Chairman*

**Robert L. Williams** *Dell Technologies Inc. - SVP of IR*

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

**Yvonne McGill** *Dell Technologies Inc. - CFO*

## CONFERENCE CALL PARTICIPANTS

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

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

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

**Asiya Merchant** *Citigroup Inc., Research Division - VP & Analyst*

**Benjamin Alexander Reitzes** *Melius Research LLC - MD & Head of Technology Research*

**David Vogt** *UBS Investment Bank, Research Division - Analyst*

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

**Krish Sankar** *TD Cowen, Research Division - MD & Senior Research Analyst*

**Michael Ng** *Goldman Sachs Group, Inc., Research Division - Research Analyst*

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

**Shek Ming Ho** *Deutsche Bank AG, Research Division - Director & Senior Analyst*

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

**Wamsi Mohan** *BofA Securities, Research Division - MD in Americas Equity Research*

## PRESENTATION

**Operator**

Good afternoon, and welcome to the Fiscal Year 2024 Third Quarter Financial Results Conference Call for Dell Technologies Inc. I'd like to inform all participants this call is being recorded at the request of Dell Technologies. This broadcast is a copyrighted property of Dell Technologies Inc. Any rebroadcast of this information in whole or in part without the prior written permission of Dell Technologies is prohibited.

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

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**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

Thanks, everyone, for joining us. With me today are Jeff Clarke, Yvonne McGill and Tyler Johnson. Our earnings materials are available on our IR website, and I encourage you to review these materials and the 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 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 Jeff.

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

Thanks, Rob. We delivered Q3 revenue of $22.3 billion with solid profitability and strong cash flow. Operating income was $2 billion. Diluted EPS was $1.88, and cash flow from operations was $2.2 billion.

In ISG, the demand environment for traditional servers improved over the course of the quarter, and demand for AI servers continues to be strong across a wider range of customers. Demand for storage was down as expected. ISG revenue was flat quarter-on-quarter with sequential growth in servers and networking revenue driven by AI-optimized servers as we begin to convert more PowerEdge XE9680 backlog into revenue. For the quarter, we shipped over $0.5 billion of AI-optimized servers, including our XE9680, XE9640, XE8640 and the R750 and R760xa servers. Customer demand for these AI servers nearly doubled sequentially, and demand remains well ahead of supply.

In CSG, the demand momentum we saw in June and July continued into August but slowed as the quarter progressed. The result was CSG revenue was down sequentially and short of our expectations. Operationally, we executed well, remaining disciplined on pricing in an increasingly competitive environment. And we controlled our expenses, focusing on profit and cash flow, including outstanding working capital performance.

And lastly, we've returned another $1 billion to shareholders via share repurchase and dividends. Yvonne will go into more details on cash flow and capital returns later.

AI continues to dominate the technology in business conversation. Customers across the globe are turning their operations upside down to see how they can use generative AI to advance their businesses in meaningful ways. These AI initiatives are being driven at the CEO and Board levels. And as a result, we are at the front of a significant TAM expansion.

AI-optimized server mix increased to 33% of total server orders revenue in Q3, driven by strong demand from AI-focused cloud service providers and growing interest from other customer verticals. We drove improved demand margins, increased services attached and incremental unstructured storage attached over the course of the quarter. The XE9680 is the fastest-ramping solution in Dell history. And in Q3, we continue to see strong demand and big wins, including customers like CoreWeave, a cloud provider that specializes in GPU accelerated workloads, and Imbue, which is using high-performance computing clusters powered by the XE9680 servers to train foundational models.

Our AI-optimized server backlog nearly doubled versus the end of Q2 with a multibillion-dollar sales pipeline, including increasing interest across all regions. That all said, AI hype is everywhere, and we need to be measured in our expectations. We are still in the early innings with AI as customers continue to work through their AI strategies. Experience over multiple technology cycles tells us that progress won't always be linear, but we are excited about the opportunity in front of us.

We believe Dell is uniquely positioned with our broad portfolio to help customers size, characterize and build GenAI solutions that meet their performance, cost and security requirements. Our AI strategy, AI in our products, AI built on our solutions, AI for our business and AI for our ecosystem partners, is the foundation for our actions, priorities, road maps and partnerships. And in Q3, we continue to build our capabilities.

We are collaborating with Meta to make it easy for our customers to deploy Meta's Llama 2 models on premises, with Dell AI-optimized portfolio. We are also collaborating with Hugging Face to help users create and fine-tune and implement their own open-source GenAI models on Dell infrastructure. And earlier this month, we introduced the ObjectScale XF960, an all-flash scale-out appliance for GenAI and real-time analytics based on our software-defined object storage solution, which can run on Linux and Red Hat OpenShift on PowerEdge servers.

Looking forward, the recovering ramp in PC demand we were expecting in Q3 has pushed out with large enterprises and corporate customers remaining cautious with their spending. The PC installed base continues to age, and there are exciting changes coming to the PC next year, including advances in AI-enabled architectures from Intel, AMD and Windows on ARM, which will help drive a PC refresh cycle. We are also seeing the beginning of a traditional server rebound, and historically, storage follows a couple of quarters later.

We are leveraging our strengths to extend our leadership positions and turn new opportunities, including multi-cloud, edge and AI, into incremental growth. And we are positive on FY25 and fully expect to return to growth next year given the expected tailwinds to our various businesses, including AI.

Technology is everywhere, and Dell is ready. The amount and value of data continues to grow, and as that happens, the opportunity for Dell Technology grows in tandem. We have proven that over 4 decades through wave after wave of innovation. And we have proven our ability to capture the growth as our TAM expands and translate that into results for our stakeholders. Regardless of the economic cycle, expect us to focus on growing and extending our core businesses in the areas with the most attractive profits to deliver innovation for our customers, remain disciplined in our pricing and focus on costs.

Now over to Yvonne for the detailed Q3 financials.

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**Yvonne McGill** - *Dell Technologies Inc. - CFO*

Thanks, Jeff. We're focused on driving a balance of growth, profitability and cash flow in any demand environment. We delivered revenue of $22.3 billion, down 10%, with strong gross margins, lower operating expense and improved working capital management. Gross margin was $5.3 billion and 23.7% of revenue, flat year-over-year.

We continue to see increased pricing pressure in Q3 but remain focused on profitable opportunities. And you should expect us to continue to maintain discipline and focus going forward. Operating expense was $3.3 billion or 14.9% of revenue, down 5%, driven by lower SG&A costs, and down 7% sequentially as we actively manage our spend.

Operating income was $2 billion, down 17%, and 8.8% of revenue with the impact of a decline in revenue, partially offset by lower operating expense. Our tax rate was 19.2% year-to-date or 15.4% for the quarter.

Net income was $1.4 billion, down 19%, and diluted EPS was $1.88, down 18%. Our recurring revenue in the quarter was $5.6 billion, up 4%. And our remaining performance obligation, or RPO, was $39 billion, flat year-over-year, with growth in deferred revenue offset by a decrease in backlog.

Deferred revenue was up primarily due to increases in software and hardware maintenance agreements and VMware resell. ISG revenue was $8.5 billion, down 12% and flat sequentially. Servers and networking revenue was $4.7 billion, up 9% sequentially. We saw server ASPs continue to expand in both AI-optimized and traditional servers, and our AI mix of server demand accelerated again sequentially given customer interest in GenAI.

We delivered storage revenue of $3.8 billion, down 13%, with demand growth in data protection and PowerScale. ISG operating income was $1.1 billion or 12.6% of revenue, down 170 basis points, driven by a decline in revenue, partially offset by an increase in gross margin rate.

Looking forward, our many #1 positions are proof of our deep enterprise expertise. And with a TAM of $200 billion growing at a 7% CAGR over the next few years, we are confident in our ability to grow the business as the market returns to growth.

Our fiscal Q3 CSG revenue was $12.3 billion, down 11%, primarily driven by a decline in units, while ASPs remained flat. Commercial and consumer revenue were $9.8 billion and $2.4 billion, respectively. CSG profitability remained strong in Q3 with operating income up $0.9 billion or 7.5% of revenue. Op inc was down 20 basis points, driven by a decline in revenue, offset by lower operating expense and an increase in gross margin rate as we maintained pricing discipline and benefited from lower input costs. With a TAM of $400 billion growing at a 2% CAGR, we will continue to focus on commercial, the high end of consumer, profitable relative performance and executing our direct attach motion for services, software, peripherals and financing.

During the quarter, we saw continued strength in APEX and our data center utility and Flex on Demand offerings and added new multi-cloud offerings, including APEX Cloud Platform for Azure and Red Hat OpenShift.

Our Q3 Dell Financial Services originations were $1.8 billion. DFS ending managed assets reached $13.9 billion, up 1%, while the overall DFS portfolio quality remains strong with credit losses near historically low levels.

Turning to our cash flow and balance sheet. Our cash flow from operations was $2.2 billion, primarily driven by working capital improvement and profitability. Working capital benefited from an approximately $200 million sequential decline in inventory, strong collections performance and continued improvement in receivables aging. Our cash conversion cycle improved again sequentially and is now at negative 52 days, a 20-day improvement since the end of last year. We ended the quarter with $9.9 billion in cash and investments, flat sequentially, driven by free cash flow generation, offset by $1 billion in capital returns.

Core leverage was 1.6x exiting Q3, flat sequentially. During the quarter, we repurchased 11.2 million shares of stock at an average price of $66.55 and paid a $0.37 per share quarterly dividend.

Turning to guidance. Enterprise and large corporate customers continue to be cautious in the current macro environment. Against that backdrop, we expect Q4 revenue to be in the range of $21.5 billion and $22.5 billion, with a midpoint of $22 billion. Sequentially, we expect ISG revenue to be up mid-single digits, driven by sequential growth in traditional servers and seasonal growth in storage. We expect CSG revenue to be down low-single digits sequentially. We're seeing pockets of stability in PC demand but have yet to see a broader recovery in the PC market. And in our other business segment, we expect to be down in the low 20s sequentially.

Operating income rate should be down marginally versus Q3, driven by a more competitive pricing environment in CSG. And for our tax rate, you should assume roughly 20% plus or minus 100 basis points for Q4 or 19.5% at the midpoint for the full year. We expect our Q4 diluted share count to be between 729 million and 733 million shares, and our diluted EPS should be $1.70, plus or minus $0.10. We're increasing our expectations for the full year diluted earnings per share to $6.63, plus or minus $0.10.

Turning to FY '25. It's still early in our planning process. However, I recognize you're thinking about next year. So let me share our current thinking. We're seeing signs of stability and inflection in parts of the portfolio, including traditional and AI-optimized servers. We expect revenue to return to growth next year, above our long-term financial framework. The opportunity is the broader IT spending recovery with large corporate and enterprise customers, particularly in the U.S.

We'll continue to focus on profitable growth, but we'll be mindful of the competitive environment and inflationary input costs as we move through the next year. Pricing discipline and cost controls will help mitigate these headwinds. Count on us to continue to execute our unique operational model focused on cash flow and returning capital to shareholders. And we look forward to updating our FY25 expectations in more detail on our Q4 earnings call.

In closing, we have strong conviction in the growth of our TAM over the long term with technology trends like AI, multi-cloud and edge in our favor. At the end of the day, our strategy is simple: Leverage our unique operating advantages to extend our #1 leadership position and capture new growth. This strategy, coupled with our P&L leverage and strong cash generation, drives a resilient long-term financial framework and capital allocation plan. We have proven our ability to generate strong cash flow through profitability and working capital efficiency, including $9.9 billion of cash flow from operations over the last 12 months. And at our Analyst Meeting last month, we committed to increasing capital returns to our shareholders.

Expect us to continue to invest in innovation, be disciplined in how we manage the business and focus on what we can control, delivering for our customers and our shareholders. We are excited about the future and confident in our ability to create meaningful long-term value for all of our key stakeholders.

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

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## QUESTIONS AND ANSWERS

**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

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

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**Operator**

We will take our first question from Amit Daryanani with Evercore.

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

I guess maybe to go to the AI server demand discussion, Jeff, that you had. I think you essentially said your orders doubled. So does that imply something north of $4 billion right now? And then how do you think that manifests itself into revenues into fiscal '25? And maybe you can touch about how broad this customer base is becoming versus perhaps hyperscaler. That would be really helpful.

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

Sure. Let me pull that apart, Amit. So I mentioned our demand nearly doubled quarter-over-quarter. And what was, I thought, very interesting about that is every part of the AI-optimized portfolio grew quarter-over-quarter, and we saw significant growth for enterprise customers. So I think that's important to note, is we saw the entire portfolio grow. We saw the number of customers grow, and we saw the number of enterprise customers grow quarter-over-quarter.

When I think about the $2 billion that you mentioned, that was a backlog comment that we made in August. And what we talked in August was a $2 billion of backlog. And that included, up until that point in time, the August first month of the quarter because that was a real-time update of our backlog $2 billion. We shipped over $0.5 billion of AI-optimized servers during the quarter. So when we think about demand nearly doubling, and I mentioned backlog doubled, we like you to part with $1.6 billion of AI-optimized servers backlog at the fiscal exit of Q3.

Equally important, we saw the pipeline in the quarter triple. I'll say that again. The pipeline for AI-optimized servers tripled quarter-over-quarter during Q3. Lead times remain 39 weeks. Demand is ahead of supply. We continue to work to improve supply. And we're working now to convert that pipeline into real sales, into orders, so we can continue to ship and benefit from this exciting time.

As far as next year, Yvonne, I'm sure, will talk about this in greater detail. But we're still in the planning process. We think it's a tailwind. We talked about it at each of our last financial engagements. It's a large market opportunity, 18% CAGR over the next 4 years, growing to $120-ish billion. There's nothing that suggests that's not the case. And it's not coming at the cost of our traditional servers.

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**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

All right. Thanks, Jeff. Next question.

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**Operator**

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

**Wamsi Mohan** - *BofA Securities, Research Division - MD in Americas Equity Research*

I appreciate the early look into fiscal '25. Given some of the puts and takes that you called out, both on revenues and margins, just wondering when you say it's going to be higher than your long-term range, is the comment pertinent to overall Dell Tech? Or is it also a comment that we can attribute both to CSG and ISG? Frankly, we're coming off cyclical bottoms, in so many of your businesses, it feels as though you should be able to materially outgrow. So any kind of maybe characterization of that would be helpful.

And also on the cost side, Yvonne, I think you noted pricing discipline, cost controls but also some headwinds. So just thinking through that, would you say that there is also upside from a margin perspective or EPS growth rate perspective?

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**Yvonne McGill** - *Dell Technologies Inc. - CFO*

Thanks, Wamsi. I'd tell you, we're certainly at the early stages of the planning process. We usually wrap that process in the January time frame. But I recognize everyone's interested in next year. So I wanted to give you a little bit more context there.

We expect to return to growth, as I mentioned on the call already, above our long-term financial framework. And so we're seeing an inflection point in traditional servers in addition to those AI-optimized momentum that we've been talking about. And we expect servers and networking holistically to be a bigger portion of our ISG mix in the next year.

If I move to PCs, our growth expectations will be dependent on the timing of the PC refresh cycle. We are also expecting a decline, and mentioned it for Q4 also, in VMware reseller revenue with no impact to profitability. We're expecting a more competitive environment overall. We started to see that in the third quarter. So we'll expect that to continue, especially in the PC market into the next year.

Other things to consider, input costs are expected to be inflationary next year, led by NAND and DRAM. And of course, as we always do, we'll continue to be mindful of our cost structure. But regardless of the environment that we're operating in, right, we will continue to execute our proven operational model. You can continue to count on us to be financially disciplined, all while driving growth, profitability and cash flow. We're really optimistic about FY25 and really excited about returning to growth, and look forward to giving you all even more context and update in our Q4 earnings call in February.

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**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

All right. Thanks for the question, Wamsi. Next question, operator.

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**Operator**

We will take our next question from Toni Sacconaghi with Bernstein.

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

Your tone on the call around the demand environment sounds very, very different than it was 90 days ago, where you talked about growth accelerating and a rebound in spending better than you had thought. And it sounds like the complete opposite this quarter. You were wildly above normal seasonality in Q2. You were below normal seasonality in Q3, and you're guiding below normal seasonality again for Q4. Did you just misgauge demand in Q2? Like was there a pull in from Q3 to Q2 and you just misgauged the characterization of demand 90 days ago? Or like what really happened and changed?

And if I could, I just want to clarify the AI situation. So it would be helpful if you could just give an update right now in your backlog relative to 90 days ago, which was $2 billion. And if I think about what you're seeing in terms of the pipeline, it sounds very credible that backlog could be like

$5 billion exiting this year. If it's a 9-month lead time, shouldn't we expect like $5 billion to $7 billion in AI server delivery? And if you're saying servers are -- demand is improving for traditional servers, why shouldn't we expect a gargantuan number for servers next year?

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

Well, Toni, that's a few questions. Let me work my way through those. So what happened? You recall in Q2, we talked about the improved demand in June and July for PCs. And that certainly helped us close the quarter, and we benefited from that. And when we were together in August, we had seen that continue in August. In fact, through the month of August, the first month of the quarter, our PC business was up year-over-year. And then things changed. The business started to slow. It slowed in September. It slowed more in October.

We saw more cautiousness from our customers. We saw them being more selective, particularly large commercial customers, enterprise customers and particularly in North America. We saw the public sector slowdown, while at the same time, we actually saw stabilization in SB. But the big change was the number of large deals slowed over the course of the quarter as our customers again became more cautious and selective.

And as the market slowed, which you've probably seen in some of the output numbers from the OEMs, we saw increased pricing pressure. So the pricing pressure changed in PCs from August to October. Those large deals became more competitive. I think you also saw inventory that was shipped in the June and July period. Now it was caught up, and you saw promotional pricing throughout the quarter. And it was more aggressive as we exited the quarter and we ended the quarter.

So that did change the PCs. We did not see or call the slowdown in our guidance. The guidance that Yvonne and I gave a quarter ago was what we saw through August, and we were optimistic that we were seeing a recovery. It's clearly pushed. Things have slowed, while at the same time, we now have 2 consecutive quarters of quarter-over-quarter growth of our traditional or data center servers, and we have the tailwind of AI continuing to grow.

As I mentioned earlier, the pipeline of AI tripled in the quarter. Demand doubled -- nearly doubled quarter-over-quarter. So those are the tailwinds of the change that we see in the business. The biggest change was PCs because storage performed as expected.

Backlog, the number I'm going to give you is the Q3 exit backlog was $1.6 billion. Orders nearly doubled. Pipeline tripled. Our job is to convert that. We're working with our field, our customers to convert that pipeline that grew significantly. The interest in our AI products continues to be strong. On-premise deployment at AI -- or interest continues to be strong. The fact that we now have been working with Meta and Llama 2, bringing that on-prem, Hugging Face in an open-source environment to bring those models and tools on-prem, I think, continue to reiterate AI is going to follow the data. The data is on-prem, and we believe the pipeline and opportunity continues to build for us.

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**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

All right. Thanks for the answer there, and thanks for the question, Toni. I'd like to think that our tone would be transparent and honest. And that's what I hope you hear from us, is that we call it like we see it, and we give you the best view that we can give you at that point in time. So appreciate the question, Toni. Next question, please.

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**Operator**

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

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

Awesome. Jeff, I just want to kind of dig into some of your comments about spending on AI-optimized infrastructure and the impact that might have on traditional hardware spending because obviously, there's a lot of money, as you're very clearly showing us, being thrown at AI-related infrastructure. So can you just maybe give us a bit more detail on what gives you confidence that this spending won't cannibalize traditional either general compute spend or overall hardware spending as we look out over the next 12-plus months? What are the signposts that you're looking at that give you that confidence?

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

Of course, Erik. Let me try. So we believe what we've seen for 2 consecutive quarters in our traditional server business is growth. That's grown sequentially from 1 to 2, now 2 to 3. What we saw for the first time this year was the pipeline actually grow in quarter for traditional servers. That's a very encouraging sign.

We saw the adoption of our brand-new 16G server double quarter-over-quarter. We saw the activity with our sales force and our accounts increased. We saw the opportunities in large deals increased towards the end of the quarter. Our conversion improved over the course of the quarter. And I think those signals tell us that this 8-quarter digestion of what was built or bought, I should say, through the course of COVID has now worked its way through the system that data centers need to be updated, upgraded additional capacity.

Those workloads continue -- need to be fed. More data is being created, while at the same time, there's a whole new category of computing, accelerated computing, AI-optimized computing fed by all of the market momentum around generative AI that says that there's a big opportunity in both that we think early signs -- I'm not going to -- I won't use that word that you probably want me to use, there's recovery, but we have early positive signs that there's a changing in the demand profile of traditional servers. And we're seeing a lot of excitement across our broad portfolio of AI-optimized servers that have us feeling pretty good, as Yvonne just mentioned, about next year.

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**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

Does that get out of your question, Erik? I just want to make sure that's...

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

Yes, absolutely. Very clear.

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**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

Okay. Good. Appreciate it, Erik. Next question.

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**Operator**

We'll take our next question from Ben Reitzes with Melius Research.

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**Benjamin Alexander Reitzes** - *Melius Research LLC - MD & Head of Technology Research*

Appreciate it. I wanted to ask about PCs with regard to your comments around 2025. What is -- are you expecting that growth to be above model? And what do you think the impact will be of the Windows 10 expiration and some of the new chips coming out that harness AI? If you don't mind touching on that, that would be great.

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

Sure. Let me take a run at it, Ben. It probably is important to set context as we're heading into calendar '24, our fiscal '25, in PCs. We expect the market to close in Q4 being down. It will be 8 quarters of negative growth in the PC industry, the longest I can recollect. And it's ripe for a refresh.

Another data point for you to think about, there'll be 300 million PCs turning 4 years old next year. That's typically a tipping point for upgrading in commercial. And most of those are notebooks. As everybody was working remote, the notebook mix went up, 300 million PCs that year. They're aging in time to refresh.

And we have the opportunity with new architectures from Intel, AMD and Windows on ARM to really begin to see AI make its way out to the edge and to PC. And it's a pretty exciting time. I've used the moniker, the notion of this is the next great application, the next great use case of the greatest productivity device on the planet, and it's coming real next year.

So I think 8 quarters of decline, an aging installed base and installed base of greater than 1.5 billion units, 750 million of them over 4 years, all 300 million more coming next year. That will age, become 4 years old, the time to upgrade. None of those are capable of running the new AI workloads coming out to the edge and the PC, new architectures coming that are exciting and interesting. And we have what you said around Windows. There's another forcing function of an upgrade.

So historically, when a new version of Windows is available or one is retired, that drives a replacement cycle, and that's an opportunity for us. So we're excited about that, particularly given our bias towards commercial. 80% of our revenue comes from the commercial PCs. I think the opportunity is good for us.

And then the other question was around the silicon alternatives. Was that it, if I remember correctly?

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**Benjamin Alexander Reitzes** - *Melius Research LLC - MD & Head of Technology Research*

I think you hit on everything. I just -- the clarification is just PC is above -- PC is also above model as well as server and ISG. That's probably the final...

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

Specifically, our internal model would have the PC market growing somewhere in the low single digits. Think 3% to 4%. You would expect us to grow -- to take share.

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**Operator**

We'll take our next question from Asiya Merchant with Citi.

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**Asiya Merchant** - *Citigroup Inc., Research Division - VP & Analyst*

A couple of questions on my end. Just on the AI opportunity that you talked about in the enterprise, maybe if you could share with us the workloads and the use cases that you're now seeing. Is this gone beyond the cloud service providers that you talked about that you're interacting with? I think you mentioned CoreWeave and Imbue on the call. But if I recall, there was some commentary as well on enterprises. So are you seeing an opportunity for your AI pipeline growing with the enterprise use cases? If you can share any anecdotes on that.

And then on share buybacks, obviously, you kicked that up this quarter. Should we expect this level of share buybacks to continue into fiscal '25? Or given improving cash conversion cycles, improving top line, we should see a further step-up in that run rate?

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

Sure. I'll lead with the AI question. A couple of maybe specific data points to help understand and characterize what we're seeing. Number of buyers up. Number of enterprise buyers up significantly. All of the portfolio saw quarter-over-quarter growth. And the reason that's important, because not everybody needs a 9680. Smaller models, smaller data sets, perfect setup for our other products, which line itself up with where we're seeing the opportunities in enterprise.

So institutions of higher education, financial services, health care and life services and manufacturing is where we're seeing pull for our products. That's data on-prem. That's models. That's doing AI and ML work across the board. That's what we're seeing, and we're pretty excited about that. And the tripling of the pipeline included enterprise customers and enterprise demand.

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

And I'll take the share buyback. Look, I think as you mentioned, look, we tripled share repurchase this quarter versus last quarter. As a reminder, last year, cash was really kind of running more on the weaker side, and we had pulled back and focused more on dilution management. And then as we've seen cash accelerate this year, it's put us in a good position so that we could be a little bit more opportunistic.

We don't typically guide around share repurchase, but I guess the way I would frame it is we're obviously very focused on the 80% plus capital return. If you go back to when we first started our dividend, which would have been FY23, the beginning of FY23, we're running at 96% return of capital. So I feel really good about that. And I do think recognizing we don't guide, I think it's fair to say, as we look forward, we'll definitely be repurchasing more than just dilution management.

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**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

All right. Thanks, Asiya. Appreciate it.

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**Operator**

We'll take our next question from Mike Ng with Goldman Sachs.

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**Michael Ng** - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

I just have 2 quick ones on AI. First, on the AI margin profile, you obviously had very strong ISG margins in the quarter despite rising contributions from AI server mix. So could you just talk a little bit about how much of a headwind to that ISG margin rate came from the rising mix of AI servers, if that's the right way to think about it?

And then second, I was just wondering if you could talk about the relationship between AI servers and networking and storage for you guys. Should we expect some of that AI sales pipeline that you talked about to eventually include selling Ethernet for AI or InfiniBand or more storage in the near term?

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**Yvonne McGill** - *Dell Technologies Inc. - CFO*

So let me start with the impact of margin rates. We did see a little bit of dilution, if you will, from the impact of the shipment, as we called out, but really not a material impact right now. We saw nice performance really across the server -- holistic server portfolio. And so that increase that Jeff already talked about in the traditional servers was helpful in that mix.

So it does have an impact, but we've talked about it being margin dollar accretive but margin rate dilutive. And so we saw a little bit of that but not to a significant extent in our third quarter. But expect as that grows, we will see more of an impact. Again, margin dollar accretive. And so -- and as we have more services attached, as we expand that into the enterprise space, we'll see more and more margin accretion coming from those AI offerings.

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

No, I think that's a great point, Yvonne. The team did a great job improving margins of our AI-optimized servers quarter-over-quarter, selling the value, the design, the performance attributes, its thermal attributes, its connectivity attributes. And then attaching storage and services around it allowed us to see improved margins quarter-over-quarter.

And Mike, to your question, is there a relationship between storage and networking with AI, absolutely. These are typically cluster -- small clusters, large clusters, high bandwidth needed. We see it ultimately deployed out where the data is being created. Much of the data that will be created in the future is outside of the data center. Much of that data is unstructured. Much of that opportunity is really a nice -- a really nice tie to what we do with our unstructured and object assets. And then networking is the high-speed interconnect, the fabric. They matter. They matter more. Whether it's InfiniBand or ultra Ethernet, those are all exciting new technologies for us.

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**Operator**

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

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

Great. I wanted to see if you could unpack what you see going on trend-wise in storage, particularly given that -- I know you said it came in as expected, but the revenue was a bit light versus Street expectations, and it looks like it's still down year-over-year in the next quarter. And where my question is going is to think about the longer-term trend because I'm wondering, is AI pulling money away from storage? And do you see essentially margins trending better or worse given shifts in input costs and the better margins that some of your peers have called out recently? Just wondering how you're seeing that trend as well.

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

Sure. Maybe a couple of data points, and Yvonne can chime in as well. From us, when you think about margins, since that was the last comment, we saw our storage margins improve quarter-over-quarter and year-over-year. That's exciting. We continue to sell the value of our products and the broad portfolio we have.

We do see customers cautious. A large concentration of the storage businesses is in very large customers, and they're absolutely being cautious and selective. And that clearly impacts our high-end product portfolio. But what was exciting during the quarter is we saw our data protection and our unstructured categories actually growing on orders basis year-over-year.

So when I think about the opportunities around protecting valuable data, when I think about the opportunities of what data is going to be created, again, unstructured largely outside of the data center at the edge, I think it's a great opportunity for us to continue to protect these valuable workloads and the opportunity for us to be where the data is created out at the edge with our vast array of unstructured assets.

So I don't think AI pulls away storage dollars. I think what we see is the effect of 8 quarters of server decline has impacted storage. Customers are cautious. Historically, as the server business rebounds and recovers, we think our experience tells us that storage lags it by about a couple of quarters. That's what we're expecting. We see nothing that suggests that's different. And in the meantime, the opportunity around unstructured is immense, and we'll continue to focus on that.

**Yvonne McGill** - *Dell Technologies Inc. - CFO*

And I'd add, Jeff, on that. The margin accretion that you referred to on storage is real, and it's great because it's going to be recognized over time in the P&L, right, with the high services and software attached. So we don't see all that benefit today, but we'll see it going forward.

**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

Next question.

**Operator**

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

**Shek Ming Ho** - *Deutsche Bank AG, Research Division - Director & Senior Analyst*

Great. I have a question on AI as well. It's great to see very good momentum in that business. Are there any concerns that some of these orders could be like just double booking just because supply is tight everywhere that, that could ease over the course of next year? I assume you have great visibility into the backlog, the $1.6 billion you talk about in terms of timing. But how about the multibillion dollar pipeline? How comfortable are you with that? And also, what I would ask about is that can you clarify what products and maybe services are included in that order number? Is that just AI-optimized service like the XE9680? Or do you include like CPU only service in there? Any professional services or even APEX as a service in there?

**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

The last one first. When we talk about our AI backlog and demand, it's not high-performance computing. It's not CPU-based. It's simply the portfolio that is optimized for artificial intelligence, the 9680, the 9640, the 8640, the 760 and the 750. That's it. So it's clear it is that portfolio that we built to be optimized for AI.

The double booking. It's a very unusual way that the marketplace is working with the role that NVIDIA plays and helping the -- obviously, the supplier or the -- they're out helping generate demand. I think there's reasonable fidelity in the demand signal that we see today. Is it possible there's double booking? I can't sit here and tell you that there's not. I don't -- from my seat, I don't see it.

When we see the opportunity of we are competing with others for the same opportunity, the opportunity is qualified. It's got to be qualified for NVIDIA to give the supply or to suggest the supply will be available. So I think there's a lot of control points in place that suggests there's great fidelity in the demand signal that we're seeing. But I can't sit here and tell you with 100% certainty that there isn't 1 or 2, but I think it's a really good demand signal. And given where our team is and what we see across the globe in enterprise with CSPs, we know where the opportunities are. I hope that helps, Sidney.

**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

Thanks, Sidney. Next question.

**Operator**

We'll take our next question from Krish Sankar with TD Cowen.

**Krish Sankar** - *TD Cowen, Research Division - MD & Senior Research Analyst*

I just had one for you. I'm kind of curious. You spoke about AI PC. What is your definition of an AI PC? And also, how much do you expect the ASP uplift to be for an AI PC? And how much incremental growth could it drive from the current 250 million unit run that you're going through?

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

Our definition of an AI PC is going to be a PC that has the performance capability to run the workload on the PC. Not a cloud service. The capability of running an AI workload in an app that has been AI-optimized and to be able to run it locally. The architectures that are coming all meet that criteria. There's variations in performance, but they're all meeting the threshold that we believe is required to call them PCs that they'll be AI enabled and AI PCs, if that's a name. And I think we're quite comfortable with that definition.

Whether it drives tremendous growth to the TAM is to be seen. What I believe is you don't want to be a PC user that doesn't have an AI-enabled chip in it. You're going to be next to people that have one, and yours doesn't, and it will perform differently. It won't be able to take advantage of some of the new exciting workloads, whether that's new forms of search, new forms of security, new forms of interacting with your PC itself, the ability to put some form of assistant around you.

Those are going to be huge productivity uplifts, and I think it's going to drive a refresh cycle. And again, the scale of this business is so large with 1.5 billion-plus units in the installed base, 950 million units sold over the last 3 years. This is a catalyst to increase the -- or reduce the refresh cycle or increase the refresh rate, whatever you prefer. And I think that's an exciting time. But I can't call what that number is. Our estimate for the marketplace is low single-digit growth. I think I mentioned 3% to 4%. That would take the market from roughly 250 to 260 next year. Let's get there. Let's get it growing again after 8 quarters of decline.

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**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

Well said. Next question.

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**Operator**

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

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

There's been a lot of questions already answered. But Jeff, I just want to ask you simplistically on the AI narrative. You mentioned 39 weeks of delivery time or lead times. Are you at all surprised that that's not starting to change? Have you seen any indications that lead times have pulled back with some of the China restrictions put in place? And I guess that with that context also, would you expect diversity, i.e., another large GPU supplier to be a factor in unlocking and converting some of that pipeline as we move into next year?

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

A couple of things. The pipeline is NVIDIA pipeline today. It's not alternative pipeline. It's NVIDIA pipeline. And I wish I could tell you, Aaron, that the backlog was less than -- or excuse me, the lead time was less than 39 weeks. I can't today. We are on the phone, working every available channel opportunity, as you might imagine, with our supply chain capabilities, to improve supply, to improve supply availability. We've offered our services. We'll help where we can. I'm hopeful for the day to tell you that supply has improved greatly, lead times have reduced, and we can work the backlog down faster. That's our job. I don't have those answers today. It's 39 weeks. We're trying to continue to get more supply. That's where we are.

As we look forward into calendar year '24, there's clearly alternatives coming. There's work to be done in those alternatives. Software stacks have to be taken care of, resolved, the opportunities around them. But there's more options coming. Their adoption rate, we'll see. But right now, that multibillion-dollar pipeline that I referenced, the backlog that we've talked about is NVIDIA-based 39-week lead time. We're working our behinds off every day to get more supply.

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**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

Next question.

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**Operator**

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

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

I guess sticking on the AI subject, you shipped over $0.5 billion of AI-optimized servers in the quarter. Just curious, with lead times holding where they are, how should we think about the trajectory of sort of what we expect for shipments in the coming quarter? Is it fairly stable in that sort of $0.5 billion range? Or should we expect some level of sort of ramp up if -- with supply easing?

And then just a quick clarification, Jeff. You've mentioned a few times now the improvement you're seeing in traditional servers. Even as you sort of called out that customers are pulling back spending in most recent months, you've seen some signs of that. Just curious, what's the driver there? Like why -- what's your insight in terms of as customers are pulling back? Why is there sort of this green shoot in traditional servers that runs a bit counter to that overall theme?

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

Well, we don't forecast shipments in terms of specific dollars by product line for the next quarter. Our shipments are -- for AI are implied in the guidance that Yvonne gave. I really don't want to break it down into a specific of how many that will ship of AI servers. But 39-week lead time, 9 months. Can kind of look at the math and go, maybe that's probably the right sort of ZIP code to be in. But we're hand in mouth for the parts.

Traditional servers and why we think there's a green shoot. I think it's the comments around -- it's been an 8-quarter digestion period, the longest that I can recollect in the server business. Data centers have aged product in. They worked through what they have bought in the early -- the first half of the COVID era. They now need to add capacity, and we're seeing that in different areas.

And to the point now, again, to be slightly repetitive, 2 quarters in a row of sequential growth, a building pipeline, which hasn't happened this year. Improved -- increased activity, improved conversion makes us still comfortable that something's changed. Again, I'm not using that word recovery, but something's changed. It's an inflection point that Yvonne mentioned earlier, and we're going to continue to obviously feed that inflection and continue to look at the opportunity.

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**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

All right. Let's see if we can get one last question in.

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**Operator**

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

**David Vogt** - *UBS Investment Bank, Research Division - Analyst*

Can you -- Jeff, can you talk to sort of the thought process if AI lead times come in a little bit more next year, what that means for your networking fabric or equipment business, and then ultimately, the pull forward, maybe the pull-through of storage? I might have missed it earlier, but I just wanted to get a sense for how that would sort of impact the rest of the ISG business.

And then just quickly on CSG. Can you kind of share with us your thoughts, maybe, Yvonne, on sort of the margin impact from higher component costs, whether it's DRAM, NAND or however you're thinking about it?

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**Jeffrey W. Clarke** - *Dell Technologies Inc. - COO & Vice Chairman*

Well, clearly, as GPU supply improves, the fabric that is associated with those units will be shipped and aligned to that. So the ability for us in our networking business will benefit from an uplift or an increase in supply. And I think that's encouraging. And as I talked about, storage attach is important. We are certainly working with our sales teams, working with -- to find the opportunities as this data is being created in increasingly greater rates outside of the data center to make sure that we're there and it's landing on Dell storage, and as it lands on Dell storage, making sure that as AI follows the data, that our AI-optimized portfolio is next to it.

I mean that's the sales motion, a set of professional services around that, a set of services that attach around that. So think of every opportunity of a model training, fine-tuning ultimately, as we get to inference is an opportunity for compute assets, which drags a set of storage assets around that, and it's got to be connected. We kind of look at that as the AI estate, if you will, and that's the opportunity. It's real, and our teams are focused on it.

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**Yvonne McGill** - *Dell Technologies Inc. - CFO*

And then on your question around component costs and the potential pressure we put on margin rates, we do run a low inventory model. And so when we have component cost increases, we try to recover them as quickly as we can by raising prices and passing those through into the market. So you'll see us continue with that. It's certainly not the first time that we've had this happen. And so it's an engine that's well tuned within Dell. But we'll have to navigate through that with the competitive environment, and we will. But it usually takes a period of time to recapture that impact of the question.

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**Robert L. Williams** - *Dell Technologies Inc. - SVP of IR*

All right. Thanks, everyone, for joining us. Yes. Thanks, David. We'll see many of you next week at Raymond James and Barclays and also the first week in January at the Consumer Electronics Show. Thank you. Have a good evening.

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**Operator**

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