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Good afternoon, and welcome to the Fiscal Year 2021 Second Quarter 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 the copyrighted property of Dell Technologies, Inc. any rebroadcast of this information in whole or part without the prior written permission of Dell Technologies is prohibited. (Operator Instructions)

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

Rob Williams - Dell Technologies Inc. - SVP of IR

Thanks, Holly, and thanks, everyone, for joining us. With me today are our Vice Chairman and COO, Jeff Clarke; our CFO, Tom Sweet; and our Treasurer, Tyler Johnson.

Our press release, financial tables, web deck, prepared remarks and additional trials are available on our IR website. The guidance section will be covered on today's call.

During this call, unless we indicate otherwise, all references to financial measures refer to non-GAAP financial measures, including non-GAAP revenue, gross margin, operating expenses, operating income, net income, earnings per share, EBITDA, adjusted EBITDA and adjusted free cash flow. A reconciliation of these measures to their most directly comparable GAAP measures can be found in our web deck and press release. Please also note that all growth percentages refer to year-over-year change unless otherwise specified, and that VMware historical segment results have been recast to include Pivotal results. Additionally, I'd like to remind you that all statements made during this call that relate to future results and events are forward-looking statements based on current expectations. Actual results and events could differ materially from those projected due to a number of risks and uncertainties, which are discussed in our web deck and SEC reports. We assume no obligation to update our forward-looking statements.

Finally, before I turn it over to Jeff, I want to address the amended 13D that we filed on July 15 disclosing that Dell Technologies is exploring potential alternatives with respect to its ownership interest in VMware, including a potential spin-off of its ownership interest to Dell Technologies stockholders or maintaining the status quo. We believe a spin-off could benefit both Dell Technologies and VMware stockholders by simplifying capital structure and corporate structure and enhancing strategic flexibility while still maintaining a mutual beneficial strategic and commercial partnership. With that said, we will not address the filing any further or take questions related to this topic.

Now I'll turn it over to Jeff.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman & COO

Thanks, Rob. We are finishing up day 171 working remotely at Dell Technologies, and the novelty of the new normal has worn off. Michael sent a note to our team members earlier this month that captures the situation quite well, and I quote, "This is going to be a marathon, and it's going to be uneven and frustrating at times." What I can tell you, and what you will see in our results today, is that our team has continued to deliver in extraordinary ways in this unprecedented environment. I'd like to provide several examples of our team's resiliency, tenacity and adaptability. The grit that is inherent in our Dell Technologies culture. These examples demonstrate why I remain so optimistic about the future of the company and our ability to consistently deliver no matter the obstacle.

We are still largely working from home. We're not alone in this dimension as we will highlight in our Q2 results. We have moved beyond work as a location. COVID-19 has made one thing clear to us: work is something you do,
an outcome, not a place or a time. And it takes teamwork and a culture that prioritizes outcomes and results over effort. Though we have team members juggling many challenges: parenting, caregiving, citizens and countries still grappling with surges of the pandemic, our employee engagement and productivity is at an all-time high. We are seeing a human transformation right before our eyes, emphasizing trust, empathy, patience and flexibility that will serve society and business long after these tough times are over.

While working from home and navigating a turbulent market, we continue to drive innovation in new and different ways. Over the course of 9 weeks in Q2, we had 9 product and solution launches, all while working remotely. We now have completed the modernization of the ISG portfolio, and the pipeline continues to fill with more innovative solutions and products to meet the needs of the new normal. We have not broken stride with customers. We may even be building deeper relationships than we were pre-COVID. Customer engagements have become more frequent, richer in content, while reaching a greater audience within accounts. Customers bring more decision-makers and technologists to executive briefings and we respond with deep solution architecture and engineering to deliver better business outcomes.

And right in the middle of this global pandemic, we paused to listen to our team members and society at large given what happened 3 days before we were last together: the murder of George Floyd. What we heard through a series of listening sessions was consistent: our Black team members want better representation, equal opportunity, efficacy and to see measurable progress against our Diversity & Inclusion 2030 goals. That's what we all want. And the work of real change within our now virtual walls is well underway.

I share this as a backdrop for the differentiated results we will report today. Our results come from a real competitive set of advantage but also real cultural differentiation and resiliency. That is why I'm excited about our Q2 performance and optimistic about our long-term trajectory.

What we know from our conversations with customers is technology has never been more important. Similar to what we saw in Q1, customers' top digital priorities are enabling learn and work from home and creating automation and agility across IT for consistency and resiliency of operations.

While the pandemic didn't start the remote learn and work trend, it is certainly accelerating it. Take the financial sector and its need to enable secure work-from-home solutions. A major bank in EMEA had to move 200,000 of their 280,000 employees to work from home. To give them the managed access to application and data they needed, we implemented a VDI solution based on VMware Horizon, VMware Cloud Foundation, VxRail, along with 200,000 VDI clients and 2,000 servers and end-to-end services, all from one partner, fully integrated, to help the bank get their employees up and running securely.

After all of this investment to enable remote everything, we will never go back to the way things were before. Here at Dell, we expect, on an ongoing basis, that 60% of our workforce will stay remote or have a hybrid schedule where they work from home mostly and come into the office 1 or 2 days a week. And we are not alone. Recent data shows that work from home is likely to increase by 20 points across all-size companies across all sectors. I think that is understated. And it will take more technology to ensure productivity and collaboration from anywhere. In our 10 years as a connected workplace, we've learned that it's a combination of technology, the right tools for workforce enablement and culture. And we are sharing these best practices with our customers as they embark on this journey. A journey that will be transformational for customers and, as the only player to be able to bring real solutions that connect the edge, core and cloud, will benefit Dell Technologies.

Also showing up in our performance is demand for simpler, more agile IT across multiple clouds. Companies rush towards the flexibility and ease of public cloud but are now looking to hybrid cloud for a longer-term answer. Essentially, customers want a new operating model, one that consistently delivers the best of all clouds: private, public and edge.

One large hospital system is a great illustration. This customer wanted to modernize their environment to better support electronic medical record and imaging needs. They were happy with their public cloud implementation but needed seamless integration with their storage solutions to pull down data from the public cloud quickly and affordably. We delivered PowerMax and PowerScale in a managed service facility connected to their public cloud,
allowing them to better manage and control their data. Because the storage is directly and securely connected to the public cloud at the source, data costs are reduced and latency issues are nearly eliminated. This is a great example of how we’re building our entire portfolio for customers’ cloud needs, with outcome-based decision-making top of mind.

Similar to cloud, customers also want to consume more technology as a service, letting them pay for only what they use and to move fixed costs to variable costs, which is critically important right now given the environment. We continue to offer Dell Technologies Cloud on the most broadest infrastructure portfolio with the new Dell EMC PowerScale Storage systems and Dell EMC Ready Solutions on VMware Cloud Foundation. Customers are finding immense value in Dell Technologies On Demand flexible consumption models. Customer demand for these models prompted us to expand our offerings to include Brazil, Chile, Colombia, India and China. That is why we are doubling down on both Dell Technologies Cloud and Dell Technologies On Demand.

Now let’s move to our second quarter results. Despite a dramatic deceleration in U.S. GDP during the second calendar quarter of the year, our team stayed focused on the customer and delivered. Overall, we had a solid quarter relative to the macro environment with revenues of $22.8 billion, down 3% and operating income of $2.6 billion or 11.5% of revenue.

Our Client Solutions Group delivered revenue of $11.2 billion, down 5%. In our consumer business, we outperformed, fueled by another outstanding quarter from our consumer direct business that was up 56% based on orders. And our consumer direct online business was up 79% based on orders. We saw strong double-digit growth across all consumer notebooks and gaming systems driven by our premium XPS and Alienware brands, which were up 25% on an orders basis. Overall, notebook momentum continues with orders up 8% driven primarily by growth in consumer and commercial notebook needs at home and for remote work and learning.

Infrastructure Solutions revenue was $8.2 billion, down 5%. We saw double-digit orders growth for data protection and VxRail in the second fiscal quarter and mid-single-digit orders growth for high-end storage. These are all sectors where we hold the #1 share position by a large margin and continue to have opportunity for growth. And while it’s a little early to comment on PowerStore performance, we continue to hear positive feedback and feel confident that the pipeline will drive profitable share gains, specifically in mid-range segment this year.

Our VMware business segment had another strong quarter, delivering $2.9 billion of revenue, up 10%. In addition to the depth and breadth of our portfolio, a big driver of our differentiated performance is our distinctive direct and channel coverage model of the entire IT market. In the second quarter, demand from government stayed strong, while education demand ramped, with orders up double digits for both verticals. Small and medium business demand improved through the second quarter as businesses opened back up once government restrictions were lifted.

Take these results and combine them with the demand that we saw from large enterprises, health care and the financial sector in Q1, and our first half was strong. We delivered $44.7 billion of revenue, $4.8 billion of operating income and $5.7 billion of adjusted EBITDA. We made the appropriate tough decisions around our cost environment in the first half to limit spending and to protect liquidity given the uncertainty of the demand environment.

Our track record of consistent profitable growth, share gains, innovation and financial returns reinforces our strategy is working and doesn’t change even amidst the uncertainty. We are focused on winning the consolidation in our core markets, innovating and integrating across Dell Technologies to create the next generation of infrastructure and to do both while strengthening our distinct advantages as a company: our go-to-market capabilities and global services footprint, our supply chain, our product breadth and integration, our financing and the strategic work we do with VMware.

Over the last 3 fiscal years alone, CSG and ISG have delivered a combined $230 billion in revenue and $18 billion in operating income. Over the last 3 calendar years, we have gained 330 basis points of share in commercial client, 510 basis points of share in mainstream servers and 120 basis points of share in mid-range
storage. We have the right portfolio and the go-to-market plans in place, and the teams are focused on driving relative share.

Back to why I'm so optimistic. The long-term trends in our business are favorable, and our sources of advantage are real. Though there is a high degree of uncertainty right now, our strategic position and the secular technology trends create long-term growth opportunities for us.

We’ve been talking about the fourth industrial revolution for a while, and now the pandemic has accelerated its arrival. Organizations have had to pivot quickly. First, to work from home and learn from home, and now businesses are taking this opportunity to reinvent their models for a more connected, digital, automated, data-intensive and distributed future. A future that is hybrid, the reimagining of work as an outcome, not a place, reinforces the value of hybrid cloud and positions hybrid as the optimal cloud model to meet the new demands of a fluctuating world, essentially creating a hybrid cloud for a hybrid workforce, utilizing cloud as the modern IT foundation to deliver consistent experiences and economics across many places workloads, and people, reside. Dell is uniquely positioned to deliver on this hybrid reality. Public cloud, sure, but also real growth and resiliency in private clouds and on-premise infrastructure.

We have a history of investing in new businesses and technology solutions that layer into our portfolio and spur growth. Emerging technologies around widespread connectivity with 5G, data-driven insights at the edge and expanding workloads in a hybrid cloud future will each create opportunities for long-term growth and value creations at Dell Technologies. Increasingly, customers are turning to Dell technologies to shape this digital future. Given the unique advantages we’ve talked about, combine these advantages with our purpose-driven culture and track record of consistently growing our core businesses while investing in the long-term future, I like our hand.

Now I'll turn it over to Tom for a look at our financials.

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

Thanks, Jeff. Overall, we were pleased with our performance, especially given the current environment. Despite the pandemic and economic headwinds, we're executing on our strategy in driving long-term value creation for Dell Technologies and our stakeholders. We're delivering relative growth and winning in the consolidation. We're creating differentiated Dell Technologies solutions through innovation and integration, and we're generating strong cash flow, enabling us to delever and create value for shareholders.

Revenue for the second quarter was $22.8 billion, down 3% year-over-year. FX continued to be a headwind, particularly in Brazil, India and China, impacting our growth rate by approximately 150 basis points. Revenue was up 4% sequentially, which was below our historical Q2 seasonal revenue range, but was in line with our expectations as we discussed on our Q1 earnings call.

Gross margin was $7.6 billion or 33.5% of revenue. Like Jeff said, we saw demand growth in education, state and local government and consumer during Q2, which impacted gross margin given these customer verticals tend to deliver less margin dollars.

The majority of cost actions taken in the first quarter remain in place and helped drive operating expenses down 4% year-over-year and down 3% sequentially to $5 billion. Some of these cost benefits are shorter-term reductions that will phase out over time. For example, we saw lower employee benefit claims during the government shelter-in-place periods, lower facilities-related costs and reduced advertising and promotional spending in certain verticals. We believe some of these cost benefits will normalize as we move through the remainder of the year as we prepare sites to bring team members back to the office and benefit utilization normalizes.
Operating income was $2.6 billion or 11.5% of revenue. While down 5%, operating income was up 21% sequentially driven primarily by the strong operating expense controls and business unit mix dynamics. Consolidated net income was $1.6 billion, down 7%.

EPS was $1.92, down 11% year-over-year but up 43% sequentially. Adjusted EBITDA was $3.1 billion, down 2% at 13.6% of revenue. For the trailing 12 months, adjusted EBITDA was $11.8 billion.

Total deferred revenue was $28.8 billion, up 14% year-over-year. Our recurring revenue, which includes deferred revenue amortization, utility and as-a-service models is now approximately $6 billion a quarter, up 15%.

As Jeff mentioned, we will continue to focus on providing as-a-service solutions for our customers across our portfolio, giving them more flexibility in cloud-like economics.

Shifting to our business unit results. Client Solutions Group delivered revenue of $11.2 billion, down 5%. Demand for remote work and learning solutions from our education, government and consumer customers drove strong consumer client and notebook performance. Consumer revenue was $3.2 billion, up 18% driven by the strong double-digit growth across all of our consumer notebooks and gaming systems. Our focus on premium consumer products is paying off. Our XPS and Alienware product lines saw combined orders growth of 25%. And as expected, commercial client was more challenged in Q2 with revenue of $8 billion, down 11%, as double-digit growth in Latitude notebooks and commercial Chromebooks was offset by reduced demand in commercial desktops.

CSG operating income was $715 million or 6.4% of revenue. CSG profitability was down from Q2 record levels last year, primarily due to less deflationary component cost environment compared to a year ago, but we are pleased with the improved operating margin profile versus Q1. We continue to be very pleased with our Client Solutions Group performance. It is a stable business that consistently delivers strong cash flow and provides scale, helping us weather the different cycles year in and year out.

ISG revenue was $8.2 billion, down 5%. Storage revenue was $4 billion, down 4% year-over-year but up 5% sequentially, and a bright spot given the macro environment. The strong demand for VxRail continued with double-digit orders growth again this quarter. Other storage highlights included triple-digit orders growth in our high-end PowerMax solution and double-digit orders growth in Data Protection. We saw softness in other areas of core storage, including mid-range. We continue to build pipeline for PowerStore and are pleased with the customer receptivity. We expect it to ramp through the second half of this year and heading into fiscal year ‘22.

Servers and networking revenue was $4.2 billion, down 5% year-over-year but up 12% sequentially. Overall, servers were still challenged with some improvement in orders for mainstream servers. Our high-value servers built for artificial intelligence and machine learning workloads saw mid-single digit orders growth, though this is still a small piece of the overall server revenue mix.

ISG operating income was $973 million or 11.9% of revenue, which was down 30 basis points, primarily due to lower server profitability as component costs were higher compared to Q2 of last year. Given the dynamics in the macro environment, the ISG results have been softer than we expected coming into this year. However, it is a critical component of our portfolio and one that we expect to improve as the overall economy and IT spending rebound. Over the last 5 fiscal years, we have grown this business organically and inorganically by more than $18 billion and is now on a greater than $30 billion run rate. It delivers excellent profitability and gives us a seat at the table during all of our customers’ most critical IT infrastructure decisions.

The VMware business unit had another strong quarter, delivering revenue of $2.9 billion, up 10%, and operating income of $894 million or 30.7% of revenue. Based on VMware's stand-alone results, subscription and as-a-service revenue grew 44% and comprised 22% of total revenue. The largest revenue contributors included the VMware Cloud Provider Program, Modern Applications, End User Computing and Carbon Black. VMware Cloud on AWS once again had a triple-digit revenue growth rate.
Before I move to the capital structure, I want to highlight Dell Financial Services, which continued its growth trajectory and had an outstanding second quarter. DFS originations were up 31% to $2.6 billion driven by strong VMware and EMEA performance. The introduction of the DFS Payment Flexibility Program in April has been very well received across all lines of business and customer segments. Earlier this month, we extended the program through the end of October with payment deferrals until 2021 as we continue to work together with our customers and partners to enable their businesses through these challenging times.

Turning to the cash flow generation and our balance sheet. We generated cash flow from operations of approximately $3.3 billion driven by strong profitability and improved working capital dynamics as some of the COVID-19-related impacts on collections and inventory partially normalized. Adjusted free cash flow in Q2 was $3.6 billion, and on a trailing 12-month basis, adjusted free cash flow was $7.8 billion. Our liquidity position is strong, and we are comfortable with our capital structure. We ended the quarter with $12.3 billion of cash and investments and $5.9 billion of undrawn revolver capacity.

From a debt perspective, we paid down approximately $3.5 billion of total debt during the second quarter, including $2.2 billion of core debt and $1.25 billion of VMware debt. Our total debt balance ended the quarter at $54.5 billion. This includes DFS-related debt of $10 billion and subsidiary debt of $6.3 billion in addition to our core debt and margin loan.

Our core debt ended the quarter at $34.1 billion. Over the last 4 years since the EMC transaction closed, our core debt has been reduced by nearly $15 billion, demonstrating our commitment to pay down debt. While the total debt balance has decreased by a lesser amount over that period, this is primarily due to the debt added by VMware to support its own strategic initiatives and debt we have added specifically to fund DFS growth as customers increasingly value the payment flexibility that our financing solutions offer. As a reminder, a majority of the DFS debt is secured by financing receivables and is serviced by the cash flow generation from these receivables.

Deleveraging continues to be the priority for our capital allocation, and we are committed to achieving investment-grade ratings. Our intent remains to reduce core debt by approximately $5.5 billion in fiscal year ‘21, which would be incremental to the $2.3 billion we’ve already paid year-to-date.

Let me provide a few comments on the rest of the year. As you know, we withdrew our fiscal year ‘21 guidance during the first quarter. There continues to be a high degree of uncertainty for the remainder of this year. The latest global GDP and industry data indicates continuing, but moderating, declines for the second half of the year. Similar to Q2, we expect Q3 revenue to be seasonally lower than prior years, which has typically been flat to down 2% sequentially. As a reminder, we are currently on track to close the RSA transaction in early September. Historically, RSA contributed roughly $800 million in annual revenue, and approximately $200 million of operating income with similar back-end loaded seasonal trends to ISG.

Turning to operating income. There are a few items that need to be considered. We saw component inflation in the second quarter and anticipate inflation again in Q3. We are seeing DRAM and SSD prices potentially softening as we move through the second half, with the benefit from this not showing up until later in the year. In addition, normal sequentials point toward a higher mix of consumer PCs in Q3, and recent IDC forecasts reflect a higher mix towards consumer PC and Chromebook units in Q3. Considering these items, along with the lower revenue sequentially, general macro challenges and VMware operating income expectations, we expect our operating margins will be lower sequentially.

We are proud of our operating heritage. We will continue to manage the business, driving above-market performance. We are focused on what we can control while navigating through the macro, adjusting for the dynamic cost and currency environments while also balancing appropriate cost actions with necessary investments.

In closing, we are winning the consolidation, and we're executing on our long-term drivers of value creation for Dell Technologies and our core markets. We are taking the appropriate corporate structure steps to optimize value, simplify and align our focus areas as evidenced by the VMware merger with Pivotal, ongoing simplification
of operations, the announced divestiture of RSA and the exploration of alternatives with VMware. We will continue to create differentiated Dell Technologies solutions through innovation and integration across the entire family.

Our goal is to create long-term value for all aligned shareholders by outgrowing our competitors, growing EPS faster than revenue and generating strong cash flow over time. And, as we continue to delever and get back to investment grade, we will look for other opportunities to return capital to shareholders.

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

Rob Williams - Dell Technologies Inc. - SVP of IR

Thanks, Tom. Let's get to Q&A. (Operator Instructions) Holly, can you introduce the first question.

Q U E S T I O N S   A N D   A N S W E R S

Operator

We'll take our first question from Katy Huberty with Morgan Stanley.

Katy Huberty - Morgan Stanley, Research Division - MD and Research Analyst

Last November, you guided to an operating margin this year that would be roughly in line with fiscal ’19. But just looking at the first half of the year, you're tracking about 100 basis points above that level. So is that still a fair target? And how do you see the operating margin playing out for the next couple of quarters?

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

Katy, thanks for the question. This is obviously Tom. So look, I think as we think about the first half of the year, I think we generally have been pleased with the operating performance of the organization given the dynamics in the macro. And obviously, a lot of that has to do with the cost dynamics that we've been able to drive in terms of the constraints we put on spending, whether that was the reductions in T&E, the head count freeze and those other cost actions that we took. As we sit here at the midpoint of the year and look forward into the back half, there are some dynamics I highlighted in my guidance section that I just want to keep you centered on, which is around we are seeing -- if you think about our seasonal pattern, Q2, Q4 generally are bigger quarters. Q1, Q3 generally are seasonally a little bit softer than Q2, Q4.

There are a couple of dynamics as we look at Q2 -- or I'm sorry, Q3, as we think about the demand environment, the mix dynamic with our client business, our CSG business, where we typically trend towards consumer in Q3 as we get ready for the holiday season. We're going to have the additional dynamic this year, I think, a bit more education and Chromebook dynamic mix in there. So that's going to -- that has some dynamics around our margin. And then I also would remind you that with the RSA divestiture, which is targeted right around the beginning of September, we'll drop some operating income and revenue out of the consolidated total.

So look, I do think that we might see a bit more downward pressure on operating margin in the back half of the year right now. We'll obviously have to watch it. And part of that would be dependent upon how do the mix dynamics play out as well as the component cost environment, which we still believe is inflationary in Q3. So I think we'll continue to look at it. First half was strong. We'll see how the back -- or solid, I should say. We'll see how the back half plays out.
Katy Huberty - Morgan Stanley, Research Division - MD and Research Analyst

Tom, is it still realistic, though, that you could see a sub-10% margin for the year like in fiscal ’19?

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

I don't think so. Not that I'm -- I don't think it gets to that level.

Operator

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

W. Chiu - Raymond James & Associates, Inc., Research Division - Senior Research Associate

This is Victor Chiu in for Simon Leopold. Can you provide us with some color around the performance verticals maybe where you saw better demand in the quarter? I just kind of want to get a sense for the pieces, the puts and takes that surprised you relative to your expectations.

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

Yes. Look, maybe I'll let -- let me say a few high-level comments, and maybe Jeff could jump in and talk about some of the business unit dynamics that we saw. I would remind you that as we -- in our call in Q1, we highlighted the fact that if you think about the seasonal pattern or the linearity pattern we saw in Q1, we saw February and March quite strong, and clearly, March spiked with the work-from-home dynamic as businesses and education institutions shifted to work from home, learn from home. But then, as you recall in our talking points, we also talked about the fact that we have seen April soften. That demand dynamic of April softening, that linearity, continued on into May, which we thought May, from a demand perspective, was quite soft. June began to recover. And then by the time we hit late June, in July, we saw week-over-week strength, improved demand, although still negative as we got through the end of the quarter from a demand perspective. And so there are some dynamics within that, within the context of the BUs in terms of how each of those BUs performed during -- as we went through the quarter.

And maybe with that, I'll turn it over to Jeff. Maybe he can give some highlights on what we saw in the ISG space and then in the PC space.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman & COO

Yes, happy to, Victor. I mean to build on what Tom said, clearly, there were a couple of trends that we saw from a vertical orientation. We saw education and government grow double digits. We saw, as Tom mentioned, the improvement over the quarter. We saw the SB and NB verticals or businesses improved week-over-week from early June through the end of the quarter. Still below normal seasonal rates, but they improved from the beginning of the quarter. We saw the largest transformational -- in the world continue to invest in digital transformation and continued to move forward digital agendas. If you look at it from a product perspective, as Tom mentioned, learn from home and work from home continue through the quarter, particularly towards the latter part of the quarter, as
many countries were preparing to send their youth back to school, which, in many cases, is going to be an online work -- learn-from-home environment.

And we saw many institutional customers who have historically been in the public sector, a desktop-based or a PC asset moving to a notebook-based asset, buying more notebooks throughout the quarter. And then lastly, we saw demand on the ISG side for our data protection products, our high-end storage products and our VxRail products. Data Protection and VxRail grew double digit in the quarter on an orders basis, and we had good demand for our high-end storage in the single digits. I hope that helped.

Operator

We'll take our next question from Matt Cabral with Crédit Suisse.

Matthew Cabral - Crédit Suisse AG, Research Division - Research Analyst

On ISG, I was wondering if you can talk a little bit more about what pricing dynamics looked like across both storage and servers in the quarter. And just if you can comment on if you've any changes in the wider competitive environment as the demand environment has gotten a little more difficult.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman & COO

Well, I think, Matt, if we were to look at servers, we remain disciplined throughout the quarter, as we mentioned in Q1 as well, very disciplined to what we see in the marketplace. There are some aggressive pricing for server deals without question. But we're not out chasing share. We don't think that's good for our business. We want to be disciplined and return profitable gains in the business. Clearly, the pressure we're seeing in ISG is more of a macro one. The macro demand of the ISG sector, both storage and server, is certainly different than we thought when we planned the year and started the calendar year back in January. We have continued to see customers slow down their investments, in some cases, sweat their current infrastructure through the first half of the year to navigate through the pandemic.

As I mentioned in the previous question, we've seen those largest customers continue to invest in infrastructure. We would categorize them as the digital leaders. Those digital leaders continue to invest in infrastructure, their digital transformation programs and projects. And we saw healthy demand in the largest companies around the world continuing to buy servers and continuing to buy storage class products. As we look downfield, if you will, and we think about what happens towards the second half of the year, you've probably seen the same forecast that we have. IDC has shown the external storage market and the mainstream server market under pressure in the second half of the year, specifically changing their forecast by roughly 600 basis points more negative. And we think we can weather the storm throughout the rest of the year. And as we look into next year, we see growth in the server market and the external storage market.

I believe the server forecasts are roughly 7% growth next year. We believe we have the right portfolio to be able to take advantage of the growth environment, that will be around -- or rebound, if you prefer. I think about the opportunities that we have in cross-selling in our buyer base, our storage customers buying servers, our server customers buying storage. The opportunity that we have in high-value workloads in the server marketplace, I think, is still an untapped opportunity for us. While we've made progress and saw growth in that area this quarter, there remains to be a good opportunity for us. And then we believe there's emerging opportunity as the telco industry standardizes on an open platform what's going to happen in edge and the data of intensive workloads that will evolve on the edge. And then clearly, the continued migration of the hybrid and private cloud world that we've seen throughout the last 6 quarters, we think that continues as hybrid cloud is the norm going forward. I hope that helped.
Operator

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

Toni Sacconaghi Bernstein & Co., LLC., Research Division - Senior Analyst

I was just wondering if you can comment on just demand in your guidance. You talked about weeks sequentially improving in terms of growth rate. And yet, you're guiding for below-normal sequential growth for fiscal Q3. Most companies are not. Most are guiding for inline or better-than-normal sequential growth unless they had a unique backlog relief or higher revenues in Q2 from backlog, which I don't think was the case with Dell. And I also recall, last quarter, you seemed relatively optimistic about the ISG business. You sound a bit more cautious about it now. I think server growth, even Q1 and Q2, was below seasonal despite the fact that it sounds like you're being quite aggressive with financing. So maybe you can just comment on -- are you incrementally negative around ISG relative to 90 days ago? Why are you not guiding for at least sequential growth if weekly order patterns are ultimately getting better? And why do you think you were below-normal sequential server growth from Q1 to Q2 despite aggressive financial promotion as evidenced by how much financing went up in the quarter, and your commentary around sequential improvement?

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

Toni, it's Tom. So look, let me set the stage, right? If you look at our normal seasonal pattern, Q1 to Q2 is generally a growth pattern, right, where Q2 has always been, for us, a strong education, state and local government buying season. Q3 -- Q2 to Q3 has traditionally been a negative sequential growth pattern for us. As we come out of that strong Q2, we start to see mix dynamics within the CSG business, with consumer starting to ramp which generally has a lower ASP, and then we step back up in Q4 generally from a sequential pattern. Our perspective this year, with what we know to date, and I'll comment on the fact -- yes, we did comment about the fact that as we got -- as we went through Q2, we saw improved demand coming into July. But the dynamics tend to change as you go into the next quarter when buying season patterns change.

And so we are, I think, thoughtfully cautious around how do we think about demand in Q3 given the dynamics within the macro and our normal historical patterns here that we think are going be slightly softer. As you look at the ISG space, in particular, we would normally see a sequential falloff Q2 to Q3. The 3-year average is around negative 2%, negative 3% sequentially, Toni, for ISG. And don't forget RSA comes out of there. So I just think we're -- and you look at the IDC forecast for Q3, which has mainstream server revenue ex China at minus 12 and external storage at minus 10, essentially. I think we just -- given that pattern and given what we're seeing in the environment, we want to make sure that we're thoughtful about how we frame the quarter. And obviously, we're going to push on this appropriately. But that's -- I think from our perspective, the frame that we're providing makes sense relative to what we're seeing.

And Jeff, I don't know if you have anything.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman & COO

Well, the only thing I would add to it is the comment I made with Matt as well is the market has more headwinds in the second half than ISG from 90 days ago. The most recent forecasts have changed. They've become more negative in both external storage and server. Clearly, we're going to continue to operate and execute a premium to however the market -- whatever the market outcomes are. But they are certainly more negative as we look at the second half of the uncertainty that Tom talked about. We're going to focus on the growth programs of where
our marketing is, our Power Up program that I talked about, I believe, in our last earnings call. Continuing to work and grow our customer base, continue to focus on the opportunities we have in cross-selling across the portfolio. We're going to continue to focus on ramping our PowerStore product as it's now in the marketplace and off to a good start. But we're facing market conditions that are very different from 90 days ago.

**Toni Sacconaghi Bernstein & Co., LLC., Research Division - Senior Analyst**

Jeff, I guess if I could just follow up. I appreciate the fact that, look, IT budgets have probably been slashed. A lot of CIO surveys suggest that. I appreciate the fact that you're always down sequentially, but you said you'd be down more than normal sequential. And that just feels somewhat at odds with the fact that your order rate was kind of improving in the back half of the quarter. So is there anything you saw -- you've seen in August that makes you incrementally more worried? Or put RSA aside, is there anything else fundamentally that you're worried about either competitive-wise that would suggest you shouldn't extrapolate some of that order improvement you were seeing throughout the quarter? I just want to be sure we're not missing anything.

**Jeff Clarke - Dell Technologies Inc. - Vice Chairman & COO**

Let's make sure, I think what Tom referenced, it was an overall number. And the one that we haven't talked about that has some headwind is the PC business. And we see a fundamental mix. While we're seeing an incremental increase in unit demand based on the learn from home and the continued work-from-home phenomena that's been underway, that is largely education-driven, that is largely lower-end ASPs that are associated with it. And I believe that's some of what Tom is referring to when we look at normal seasonal patterns. This is different. So if you look at the opportunity in the PC marketplace and where the growth is, it is heading towards the lower-end ASPs on that side of the marketplace. Does that help?

**Toni Sacconaghi Bernstein & Co., LLC., Research Division - Senior Analyst**

Yes.

**Jeff Clarke - Dell Technologies Inc. - Vice Chairman & COO**

So a combination of increasingly more negative outlook of the ISG sector; we're going to continue to drive our performance, and you saw some good performance in our data protection business, as I mentioned, high-end storage, VxRail; and then the PC dynamic is another one that is -- it's very different than what we've seen in any other seasonal pattern between Q2 and Q3.

Tom, anything to add?

**Tom Sweet - Dell Technologies Inc. - Executive VP & CFO**

No, I think you've articulated it, Jeff.

**Operator**

We'll take our next question from Wamsi Mohan with Bank of America.
Wamsi Mohan - BofA Merrill Lynch, Research Division - Director

Just a follow-up on those PC comments. Your PC competitor just called out CPU and panel constraints. Is there an element on the below seasonal from a commodity procurement and supply chain perspective, too? Or is that not an issue for you guys? And I have a follow-up, if I could.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman & COO

Well, Wamsi, I think there are a couple of things. I'm going to separate on this. If you think about -- what's just happened is even IDC, within the calendar quarter, Q3 has changed the forecast outlook for the calendar quarter we're in by 20 points. I've been at this a while. I've never seen that much change in a 6-week period with 7 weeks to go, which, to me, suggests that there is unanticipated demand driven from learn from home, a one-to-one education initiative. If I recall the comments I made just moments ago about the public sector, more of those workers that are at home need notebooks. That demand wasn't planned. So if you think about where the industry has been and where the demand is today, we would have had to call that many months ago given the lead time for silicon and the lead time for LCDs. That's the backdrop of where that demand is.

If I look at our portfolio, it's a very broad portfolio, as you know, we have products on standard lead time across the board. But in these areas where the growth is, think Chromebook of 11.6-inch screens, education notebooks of 14-inch and 15-inch TN screens, if you look at the supply constraints there, there's supply constraints with LCD, typically on glass itself and the drivers themselves, and there aren't enough low core count CPUs for the industry to respond to this demand profile. Do I think we will solve it in time? Without question. Is our supply chain responding accordingly? Yes. We're solving this each and every day. The lead times in our products service are getting better by the day. But that's the challenge in front of us. It's a good challenge. It's one that I know we will respond to. But it's this unanticipated spike in demand in this particular subsegment that has driven industry shortages, which I'm sure you heard from everybody, we're responding to.

Wamsi Mohan - BofA Merrill Lynch, Research Division - Director

Okay. That's helpful. And I was wondering if you might be able to share some color on how investors should think about the timing to investment grade? I mean we have sort of -- prior to your announcement on the alternatives you're exploring with VMware, there was an expectation around this timing. And now with this in the mix, can you help us think through whether that changes the timing on the path to investment grade or how investors should think about that?

Tyler Johnson Dell Technologies Inc. - Senior VP & Treasurer

Wamsi, it's Tyler. Look, I think we've talked a little bit about -- obviously, we're in kind of a different environment, right? I think the one thing that I'm really happy about, and I think we're doing a great job of, is the continued debt paydown. Obviously, we've reiterated the $5.5 billion that we're going to pay down this year. And if you look at our payout profile, right, I've got nothing else to do this year. And probably, a piece of that $5.5 billion will be focused on the debt that's coming due next year. So I feel really good how I'm positioned from a capital structure position and then also how the debt is coming down. My conversations with the rating agencies remain good. I think, obviously, they're working through a lot as they're thinking about the overall macro environment. And I think it's fair to say that that's going to influence any type of decision. But we're making the right progress, and I'm happy to see the direction we're going. So we'll continue to see how the rest of the year plays out. But I think, like I said, we're doing what we need to do.
Tom Sweet - Dell Technologies Inc. - Executive VP & CFO

Tyler, we’re at $34 billion of core -- $34.1 billion of core right now, I think we’ve done a nice job. We do -- and from a capital allocation policy, Wamsi, nothing's changed, right, in the sense that we’re going to -- predominant use of our capital right now is debt paydown. And I think that continues until we get the capital structure back into that investment-grade range. And the timing of that will be somewhat dependent upon the rating agencies who consider not only our stand-alone results but also the overall macro and their perspective around that. So I think we'll continue to be very focused on it.

Operator

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

Shannon Cross - Cross Research LLC - Co-Founder, Principal & Analyst

Jeff, I'm curious how -- from a strategic standpoint, thinking about like the post-pandemic work environment, both for Dell but also, obviously, for your customers, I'm just curious how that's changing where you're focusing your investments. I know some out there have said up to 50%, which seems pretty aggressive if people won't come back to the office. But I'm curious as you look sort of a couple of years down the line how this is changing things.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman & COO

Thanks for the question, Shannon. It's an interesting dynamic that we see underway right now. If I look at Dell, I think I mentioned this in our prepared remarks, we see us being a connected workplace now for almost 12 years, a future where 60-plus percent of our professional workforce will work in a remote or hybrid environment, where they come to the office 1 or 2 days is the definition of a hybrid workplace. And that workplace itself will transform. Rather than having pre-described or predetermined workspace, the workspace is going to be much more highly collaborative, much more open to drive that sort of collaborative nature that we think happens in the future of work. Our belief is that we think, and I think it's understated, that we'll have a 20- to 30-point increase in remote workers and remote -- or hybrid type of work environments across all company types, all sectors, all geographies. And I think what's interesting is how the PC industry will navigate how to, what we've coined as the 3 phases, do it light, do it right and then the new innovation that leads to a modern PC experience. Given where things are today, we're still much more on the do it light where we're taking sectors that have historically been behind on the mobile phenomena. Public is one of them or, quite frankly, education that's been behind. And we're just getting compute assets in their hands to enable them to work remotely to work online. We will move to a phase where doing it right is going to take over, and we're going to see, I think, a lot of innovation and play to our broad end-to-end portfolio. Things such as unified workspace are going to matter where we can actually take on life cycle management. We can do provisioning of the PC via our cloud capability. We can do app and patch updates remotely. We can do proactive and predictive service calls.

So we can change the dynamic of the asset that's in our customers' hands and then how do we make that asset more productive in time because we still see, and I think it's proven time and time again here, over the first 6 months of this calendar year, the PC remains the primary productivity device. And it's increasingly the essential learning device in an online future way to educate the world, too. I think that bodes very well for us as an industry. I think we have to navigate some of the changes and what types of products are in each of those types of end users' hands. And then we're really excited about the innovation that it will drive long term as we modernize that
PC experience and thinking of this even perhaps as more of an as-a-service experience long term on the PC side. Does that help?

Shannon Cross - Cross Research LLC - Co-Founder, Principal & Analyst

Yes.

Operator

We'll now take our final question from Rod Hall with Goldman Sachs.

Rod Hall Goldman Sachs Group Inc., Research Division – MD

I wanted to come back to the mid-range weakness comment you made, Jeff, and try to tie that back together with PowerStore and understand -- well, first of all, is that mainly related to SMEs being weak, which I think a lot of companies have seen? And then secondly, on PowerStore, are you seeing it taking people longer to test the product? And is there anything you're doing short term with regards to pricing of other products or offering of other products to try to help people out while they evaluate PowerStore in this difficult environment?

Jeff Clarke - Dell Technologies Inc. - Vice Chairman & COO

Sure. Let me start with a couple of thoughts because I love the question. One is, I think, it's important to note we've completed the journey that I've spoken to you all over the past handful of years now of modernizing our ISG portfolio. The entire ISG portfolio now is powered up in our definition. If you think about the last 3 products of those 9 products that we launched over the quarter, PowerStore, PowerScale, PowerFlex are all on the marketplace around the rest of the portfolio. Next week is an interesting time for us because the world's largest sales force is going through their annual technical training and will be clearly amped up on our new portfolio and its competitiveness across each and every sector that we participate in.

Specifically with PowerStore, what we have done is we're doing more demos, more virtual demos. Clearly, this virtual world has made it a little more difficult, but it's a long selling cycle to begin with. We always thought about our PowerStore ramp in the second half of the year converting the pipeline that I talked about last time. If I was to reflect on what's happened in Q2, I would tell you, we're very happy with the early traction we've had with PowerStore. At less than a quarter of shipping, we have already acquired hundreds of new customers, 20% of them are new to Dell. 20% of our PowerStore customers are new to Dell. What's probably the more compelling from my point of view is we're seeing a strong correlation with our competitive swaps that are up 32% quarter-over-quarter. And we've seen 2x the level of competitive displacement revenue than the previous quarter since the launch of PowerStore.

I think about the largest storage sales force on the planet, their expectations are high. They're enthusiastic about the product. Our expectations haven't changed at all about PowerStore. That sales force is out generating hundreds of new opportunities a week. We're doing many virtual demos every week on top of the pipeline that we referenced last time. So we absolutely believe we have a winner here. Our expectations haven't changed. Yes, we're dealing with a COVID environment that takes a little longer to do some of the evals, some of the certifications. But our team is being creative, helping customers do that. And then your last question about pricing, we didn't change our pricing on PowerStore. We went into the marketplace, and we priced PowerStore against the competition at the same level on an effective gigabyte. So in my mind, we've put a better product potentially in
the hands of the market at the same price as our competitors on an effective gigabyte. I think that's a win in our hand.

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**Rob Williams - Dell Technologies Inc. – Senior VP of IR**

Thanks, Rod. And thanks, Jeff. All right. That's a wrap on Q&A. We'll see many of you virtually at the Citi Global Technology Conference on Tuesday, September 8. So thanks for joining.

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**Operator**

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