DELL INCORPORATED

Moderator: Robert Williams
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Robert Williams: Good morning and thanks for joining us. With me today is our chief accounting officer Maya McReynolds.

We've posted the webdeck for today's discussion with the recast financial information on our Investor Relations website. The slides are intended to follow today's discussion. We also filed the slides on Form 8-K with the SEC this morning. I encourage you to review these documents in conjunction with this call.

Moving to slide 2, during this call, we will reference non-GAAP financial measures, including non-GAAP revenue, gross margin, operating expenses, operating income, EBITDA and adjusted EBITDA on a continuing operations basis. A reconciliation of these measures to its most directly comparable GAAP measure can be found in Appendix C of the webdeck.

Next, I'd like to remind you that all statements made during this call that relate to future results and events are forward-looking statements, based on current expectations. Actual results and events could differ materially from those projected, due to a number of risks and uncertainties, which are discussed in the risk factor section of our FY18 10-K. We assume no obligation to update our forward-looking statements.

Turning to slide 3, the purpose of today's call is to help investors understand our transition to the new accounting standard for revenue: ASC 606, Revenue From Contracts with Customers. We will provide a description of the impact to our historical financial results for FY17 and FY18. Please note that we will not be discussing any other topics other than the new accounting standard.

Before turning it over to Maya, I want to take a moment to clarify a few terms we'll be using today. We will refer to the prior revenue accounting standard as ASC 605, and we will use the term 'As Reported' to refer to the financial results previously reported under ASC 605. We will refer to the new revenue accounting standard as ASC 606, and we will use the term 'As Recast' to refer to the financial results for the same historical periods that reflect the new accounting under ASC 606.

Moving to slide 4, I want to call out a few items to keep in mind as you review the presentation.

First, we are adopting ASC 606 in the first quarter of FY19 and we will report under ASC 606 when we share Q1 results in the first week of June.

As a reminder, our GAAP results will include substantial non-cash purchase accounting adjustments for the next several years related to the EMC acquisition.

We are still assessing the tax effects of ASC 606. As a result, the Consolidated Statement of Financial Position, cash flows, and net income are not included in this presentation. Selected Balance Sheet amounts are provided in Appendix B of the webdeck. We will release the full updated financial information with tax effects in conjunction with our Q1 results.

The VMware business results discussed today reflect the operations of VMware within Dell Technologies and are different from VMware's results on a standalone basis.

We'd also like to remind you of a few items that are specific to FY17.

Results only include EMC and VMware as of September 7, 2016, the acquisition date.

Our financial information presented today contains information on a continuing operations basis. The results of divested businesses – Dell Services, Dell Software Group, and Enterprise Content Division – have been excluded from the financial information we will present today.

Lastly, FY17 was a 53-week year as compared to FY18, which was a 52-week year.

With that, let me turn the call over to Maya.

Maya McReynolds: Thanks, Rob, and good morning everyone.

In May 2014 the Financial Accounting Standards Board issued a revised revenue standard, known as ASC 606. The new standard requires companies to recognize revenue when they have transferred control of products and services and there are no further obligations to the customer.

In addition, the new rules change how transaction value is allocated to revenue recognized upfront versus revenue deferrals. For Dell Technologies, this generally results in revenue being recognized earlier in comparison to ASC 605.

We have applied the full retrospective method to reflect the changes from the adoption of this standard to all periods presented in our financial statements. This results in an adjustment to the opening balance sheet for FY17 of an approximately $1 billion pre-tax benefit to retained earnings for the cumulative changes in the periods prior. Since EMC, including VMware, was acquired in September 2016, the acquired EMC balance sheet was not subject to the opening FY17 balance sheet adjustments.

On slide 5, we've included the impacts to FY18.

The primary changes to revenue relate to how revenue is allocated across our offerings and when revenue can be recognized. For Dell Technologies, the most significant impact was related to our software offerings, both Dell Technologies-owned and third-party; our extended warranty offerings; and the customer rebates related to these offerings.

Another change to the P&L relates to the timing of recognition associated with sales commission expense. Sales commissions for arrangements longer than one year are now capitalized and amortized typically over a three- to seven-year period.

As a result of all of these changes, As Recast net revenue increased $380 million in FY18, a less-than-1 percent change from our As Reported revenue; gross margin increased $483 million, a 2.4 percent increase; and our operating loss improved $917 million, representing a 27.5 percent improvement.

From a balance sheet perspective, there are a few key changes. Most notably, there is a decline in deferred revenue, which correlates with the earlier recognition of revenue as I just described. Additionally, we will present third-party software deferred revenue and deferred costs on a gross basis, rather than the deferred cost as an offset to deferred revenue, which was how it was reported previously.

We have included a number of examples in Appendix A to help illustrate how the new standard impacts the accounting for and timing of revenue recognition of our various products and services.

Before we go to the next slide, I should emphasize that ASC 606 does not require a change to our operating model, customer billings, or our operating cash flows.

So on slide 6 – to aid in the understanding of the differences between the As Reported amounts and the As Recast amounts – we have provided bridges for FY18 revenue and deferred revenue.

Starting with the chart on the left for revenue, the $380 million net increase in revenue is driven by earlier recognition in FY18 offset by revenue amounts recast to prior years for offerings sold prior to FY18. These amounts were previously recognized over time per ASC 605.

The chart on the right-hand side bridges deferred revenue as of the end of FY18 from As Reported to As Recast. The net $1.4 billion decrease in deferred revenue is due to the timing of earlier revenue recognition offset by an increase related to the gross presentation of third-party software deferred costs.

On slide 7 we have included a summary view of consolidated results on both a GAAP and a Non-GAAP basis for the full-fiscal years '17 and '18. You can find a quarterly view of FY18 on slide 17 in Appendix B.

As you can see on this slide, adjustments for ASC 606 in FY18 are the same for both GAAP and non-GAAP results. Since we've covered the dollar impacts on previous slides, I want to focus on the improvement in margin rates from As Reported. Gross margin as a percent of revenue improved 50 basis points for both GAAP and non-GAAP. There is no change to the recognition of cost as a result of the new standard; however, for third-party software offerings where we have deferred cost, we changed the cost recognition pattern to align with revenue. The GAAP operating loss as a percent of revenue improved 120 basis points, while non-GAAP operating income as a percent of revenue and Adjusted EBITDA as a percent of revenue each increased 110 basis points.

I'd now like to cover the impact of the adoption of ASC 606 to each of our three business units: Client Solutions Group, Infrastructure Solutions Group and VMware. As a reminder, the VMware business unit results are different from VMware's results on a standalone basis.

Slide 8 provides the As Reported versus As Recast results for each of our three business units, including the Commercial and Consumer categories within CSG, and the Servers and Networking, and Storage categories within ISG. A more detailed view of our business units for FY18 by quarter can be found on slide 18 in Appendix B.

Before we get into the specific results on this slide, I want to note that we made two business unit reporting changes effective Q1 FY19 and have incorporated these changes to our Recast figures on a retrospective basis in order to conform presentation. These changes included moving Virtustream from the ISG results into Other businesses and moving certain after-point-of-sale services revenue from CSG into ISG.

So let's start with CSG. You'll see at the top of slide 8 that on a year-over-year basis, growth rates remained relatively unchanged. Total revenue for FY18 decreased $237 million, which represents a less-than-1 percent change from As Reported numbers. Operating income decreased $149 million in FY18 and declined 35 basis points as a percent of revenue from As Reported results. The decline is primarily due to the after-point-of-sale reporting change that I just mentioned.

ISG and VMware FY18 revenue increased $265 million and $69 million, respectively, each of which represented an increase of 0.9 percent from As Reported. ISG operating income increased $889 million and increased 280 basis points as a percent of revenue, while VMware operating income increased $289 million and increased 330 basis points as a percent of revenue.

You'll notice that at an operating income level, ISG and VMware recorded the largest impact when recast. This is largely due to the timing of the EMC acquisition and the effect on software arrangements of the new standard. Impacts to the ISG operating income are also heightened as a result of the business unit reporting changes.

Before we go to Q&A, let me quickly summarize the key points:

First, the change to net revenue is less than 1 percent from our As Reported revenue.

Second, there is no change to our operating model, customer billings, or operating cash flows as a result of the new rules.

And lastly, ASC 606 resulted in a greater impact to ISG and VMware than CSG, though reporting changes to our business units are also impacting our As Recast figures.

We hope you have found this presentation helpful in understanding the impact of the new revenue accounting standard for Dell Technologies, and we encourage you to review the various appendices in the presentation for additional details related to our recast financial information.

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

Robert Williams: Thanks, Maya.

Let's get to Q&A.

We ask that each participant ask one question, with one follow-up, if you have one.

Regina, can you please introduce the first question?

Robert Williams: Thanks, Maya.

Let's get to Q&A. We ask that each participant ask one question with one follow-up if you have one.

Regina, can you please introduce the first question.

Operator: Our first question will come from the line of Ana Goshko with Bank of America Merrill Lynch. Please go ahead.

Ana Goshko: Hi. Thanks very much. A very helpful presentation. I appreciate it. So my question is, so when we look at adjusted EBITDA, there was an 11 percent improvement in FY '18 adjusted EBITDA, and that metric is generally considered a rule of thumb for operating income cash flow. So are these recast results a better representation of cash flow because of the way that revenue is no longer being deferred?

Rob Williams: Do you want to take that one, Maya?

Maya McReynolds: Sure. Ana, I do think that adjusted EBITDA is an indication of our operational earnings. And as we stated before, there is no impact to operating cash flows as a result of this standard.

Ana Goshko: Right. I understand there's no change to operating cash flow. But, again, EBITDA is a rule of thumb metric that's used to measure the operating income on a cash basis. So for example, from the credit standpoint we use that as -- using this new EBITDA credit metric for core debt have improved by about half a turn. The leverage looks better. So I'm trying to just get an assessment here if this is a better way of looking at the adjusted EBITDA metric, because it more closely aligns to the cash receipts or not?

Rob Williams: This is Rob. I think that generally when an accounting standard change more closely aligns the accounting to the cash earnings, that's a positive. And I think in the case of this accounting standard change with ASC 606 that is the case. So you've got a better alignment between cash earnings and the reported accounting. So I think it is a positive change. And we see it as being beneficial in that way.

Now how the rating agencies handle it, we're really going to have to leave it up to them to work through this, because to your point, yes, it is a half a turn change, but if you look at it as we restated or recast FY '17 and FY '18, '17 has some changes in it because of the acquisition, but '18, the same changes happen there. So the changes flow through. So again, there's no impact to cash. And so there's no impact to our debt either. So we'll have to wait to see how they approach it.

But I do generally agree with you.

Ana Goshko: A follow-up, so the point was made on the slide that there's no change to the recognition of cost as a result of the new standard, but then I think you said that you are making changes to costs, and that's why we see while the revenue impact was in FY '18 only 380, the EBITDA impact was 917. So could we understand why the costs have come down?

Maya McReynolds: So the point on the slide was around cost of revenue, and in the talking points where we discussed, or I mentioned how we adjusted deferred cost timing for our third-party software products and the related adjustments. There's also the commission, sales commission expense adjustments and change.

Rob Williams: So correct me if I'm wrong, Maya, but this is really more about COGS versus Opex.

Maya McReynolds: That comment was more about COGS.

Rob Williams: Yeah, so it's more of a COGS comment versus an Opex comment.

Ana Goshko: Okay, but the net takeaway is both on the revenue and the cost standpoint, the new EBITDA results should better align with the actual cash operating income metrics. Is that a fair takeaway?

Rob Williams: I think that's fair. I think that's a fair takeaway.

Ana Goshko: Okay, great. Thank you very much for doing this call. It's very helpful.

Rob Williams: Sure. Thanks for the questions.

Operator: Our next question will come from the line of Jeff Harlib with Barclays. Please go ahead.

Jeff Harlib: Hi. Good morning. Just with these restatements can you talk about a potential impact on next year's comparable numbers, given less deferred revenues. I know it's not an easy answer and there's a lot of moving parts. But how should we look at that for this coming year?

Maya McReynolds Hi, Jeff. So as you know we typically don't provide guidance. Okay. And you're right, there are a lot of variables to consider in your mix of business and how this would be applied. I would also call out our impact is more pronounced, because of the timing of the EMC acquisition in September of 2016 and how that flows through into this restatement. But we do expect the impact to moderate over time. We're not going to give any specifics.

Rob Williams Jeff, the trick here is you think into the current fiscal year, FY '19, is really -- it depends on the mix of business. It depends on the pace of revenue change and there are some factors there. And since we don't give guidance there's not a whole lot more we can do there, other than Maya's point that she made, ceteris paribus, all else equal, we do expect it to moderate over time.

Jeff Harlib I mean is there a period over which those deferred revenues that you adjusted for amortized? Is it a one -year, two-years, multi-year? So can it have -- obviously we're all going to have to reflect new estimates based on a somewhat material change in EBITDA.

Maya McReynolds Yeah, so the timing of our deferred revenue hasn't changed. It's still on average 30 months.

Jeff Harlib Okay. And just with ISG and VMware, that changing cost, is that more commission recognition or is it more of a third-party software adjustment that you talked about?

Maya McReynolds Can you repeat the question?

Jeff Harlib Yeah, just the impact on Opex that you talked about in ISG and VMware, would you say that's more related to the reporting of commissions and the deferral there? Is it more the third-party software recognition you talked about?

Maya McReynolds I understand now. Yeah, so the operating expense impact for VMware and ISG is related to sales commissions.

Jeff Harlib Great. Thanks for holding the call.

Rob Williams You bet, thanks.

Maya McReynolds Thank you.

Operator: Once again, ladies and gentlemen, if you do have a question press star one on your telephone keypad and our next question will come from the line of Thomas Egan with JP Morgan. Please, go ahead.

Thomas Egan: Good morning. Thanks for taking the call. And thanks for hosting this. This is as good as I've seen from anyone. We appreciate it. A question on taxes, I know you're going to provide us some more details on that when you've got things worked out a little bit better.

But how should we think about the general direction of that as we realign our models for this quarter? Is it in general? I have to always remind myself about the differences between tax accounting and financial accounting. Is the tax accounting going to flow generally speaking with the financial accounting changes that you put forth here, so that generally speaking cash taxes go up, because of the accounting changes you've made?

Maya McReynolds: Thanks, Thomas. We're still working through what that looks like. So I don't think we're prepared to answer or provide any direction at this point there on that. They're still working through flowing this through the tax models and the tax reform.

Rob Williams: Tom, sorry, the plan would be to disclose that with Q1 earnings, which is in the first week of June. So we'll get it out to you guys at that point. I apologize, but we wanted to get as much to you at this point in time, and we just have not finished all the work on the tax side.

Thomas Egan: Okay, since I whiffed on that one, is it, in general, though, forgetting about the changes in the tax law, because we know that that's going to do something one way or the other, if there were no changes in the tax law, does this change in accounting also reflect in your tax accounting? In other words, are you going to recognize revenue faster in your tax accounting? Can you at least give us that idea of whether you're doing that?

Maya McReynolds: It would depending on the timing and offering mix between the tax accounting rules and the book accounting rules.

Thomas Egan: Okay. All right. Thanks. Thanks again for this. This is very helpful.

Rob Williams: Yeah, thanks, Tom.

Operator: At this time, I'll turn the conference back over to management for any further remarks.

Rob Williams: Great. Well, thanks everyone. Thanks for joining us.

As I mentioned during the call, we will have our Q1 earnings results announcement the first week in June, and we look forward to catching up with you on this topic and others at that time.

Thank you.

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

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