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Good afternoon, and welcome to the Fiscal Year 2020 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 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.

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

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, EPS, EBITDA, adjusted EBITDA and adjusted free cash flow. A reconciliation of these measures to our 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.

Finally, I'd like to remind you that all statements made during this call that relate to future results and events are forward-looking 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.

Now I'll turn it over to Jeff.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman

Thanks, Rob. At our September business update with investors, I talked about our 2 focus areas: first, innovating and integrating across Dell Technologies to create the technology infrastructure of the future; and second, innovating to win in the industry consolidation. We are making solid progress on both, which is what I will update you on today. Plus, I'll give you my take on the demand environment.

Customers are looking for -- to Dell Technologies to help them reinvent and automate all parts of their business, essentially help them build the infrastructure of the future so they can quickly respond to market trends, customer needs and drive business outcomes. This drives long-term value for our customers and for us. It also drives us to innovate and invest in new technologies that are simpler, faster and more capable, even autonomous, all designed to be consumed the way customers want based on their business needs. We continue to invest in our power portfolio across ISG, which represents our best innovation and capabilities for the data era. We shipped PowerMax with storage class memory, an industry first to market, and it's now 50% faster. In September, we announced the PowerProtect DD Series that now features a modern software stack with 38% faster backups and 36% faster restores.

Most recently at our Dell Technologies Summit earlier this month, we introduced our all-in-one autonomous infrastructure, PowerOne. Part of the Dell Technologies Cloud portfolio, PowerOne helps customers simplify their path to hybrid cloud, combining PowerEdge compute, PowerMax storage, PowerSwitch networking, PowerProtect data protection and VMware virtualization all in a single system with intelligence built in to automate thousands of manual steps during its life cycle.
Further, we made the industry’s broadest infrastructure portfolio simpler to consume with Dell Technologies On Demand, letting customers pay for infrastructure as they use it, freeing up resources, money, time and people to focus on their -- to focus on transforming their business in today's on-demand economy. This gives customers the ability to plan and predict around peak data consumption and IT spend cycles.

We are excited about what these new innovations make possible for our customers and what they represent in terms of how we’ve readied the ISG of the future over the -- or how we've readied ISG for the future over the past 2 years. We’ve stabilized the business, reclaimed share, simplified and powered up the portfolio and added sales resources to fuel growth.

At the Dell Technologies Summit, Michael unveiled our ambitious new goals for 2030 focusing on inclusion, sustainability, transforming lives through technology and data privacy. For example, by 2030, our goal is that 100% of our packaging will be made from recycled or renewable material, and more than half of our product content will be made from recycled and renewable material. And for every product a customer buys, we will reuse or recycle an equivalent product. These initiatives follow what we've achieved over the past 10 years, like recovering more than 2 billion pounds of used electronics via responsible recycling and reusing 100 million pounds of recycled content and other sustainable materials in our new products. We have a strong record -- strong track record here to build on which helps us win in the marketplace.

We've made some important social impact commitments that are increasingly important to our customers, team members and investors. I encourage you to learn more on our website and through the replay of the summit event.

Before I get to the demand environment, I want to remind you of our operating framework that remains unchanged. We expect to outperform the market and take profitable share. We have gained 375 basis points of storage share over the last 2 years, 580 basis points of mainstream server revenue share over the last 3 years and approximately 600 basis points of PC share over the last 6 years.

Now shifting to demand. From a customer set and geographic perspective, we see solid demand in small, medium and commercial accounts with weakness in China and some softening in the large enterprise space. From a business unit perspective, we see softness in infrastructure solutions demand driven by servers, while client solutions and VMware are solid.

Let me share a few examples. Our storage business grew 7%. We saw strong Q3 demand in data protection and hyperconverged with VXRail orders up 82%. We expect to gain storage share in North America in calendar Q3. More importantly, our customers and sales teams are optimistic about our portfolio and positioning.

The server demand environment remains challenged as many customers continue to digest last year’s unprecedented growth. Excluding Greater China, our Q3 server order revenue was down mid- to high single digits. While the server market remains soft, we continue to focus on growing our server buyer base, which was up 5%, growing year-over-year for the fifth consecutive quarter. In addition, our server business benefited from an increasing mix of high-value workload platforms, increased memory and storage content and component cost decreases. We expect to gain share in North America and in EMEA and retain our #1 share positions in x86 mainstream server revenue and units.

Client solutions demand remains healthy with tailwinds from the Windows 10 refresh cycle expected to continue and then fade into the first half of next year. IDC is projecting a declining post-Windows 10, which will be a headwind to CSG in fiscal ’21 overall.

In Q3, CSG delivered strong results across commercial. Going forward, we remain focused on direct growth and optimizing our channel relationships. We have invested in our sales forces in both small and medium businesses and continue to accelerate growth there. In consumer, we will focus on direct sales and high-end premium PCs, including XPS and gaming, as well as increasing our attach of services, software and peripherals.
We expect the component cost -- we expect component cost to remain deflationary in aggregate through Q1 of next year but at a significantly lower rate than the last 3 quarters. We are now seeing inflation in SSDs with 20% inflation expected in Q4 and DRAM inflation beginning in Q2 of 2020 per industry and analyst estimates. We clearly have captured the operating benefits from the significant cost declines in fiscal '20, and it will be our job to mitigate these expected increases for our customers and for Dell in fiscal '21.

And finally, Intel CPU shortages have worsened quarter-over-quarter, the shortages are now impacting our commercial PC and premium consumer PC Q4 forecasted shipments.

Now I will turn it over to Tom to take you through our financial results and guidance.

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

Thanks, Jeff. We have executed relatively well this year and again in Q3 as we balanced revenue and profitability with more challenging market conditions.

Revenue was $22.9 billion, up 1%. FX remained a headwind this quarter impacting growth by approximately 110 basis points. Our deferred revenue balance increased to $25.9 billion, up 17%, driven by our services and software businesses, adding revenue and cash flow stability. Gross margin was up 11% to $7.8 billion and was 33.9% of revenue, up 300 basis points, driven by lower component costs and pricing discipline.

Operating expenses were $5.3 billion, up 8%, due in part to investments we have made in sales coverage to broaden solution sales capabilities and expand buyer base. Operating income was up 18% to $2.4 billion or 10.7% of revenue. Our consolidated net income was $1.4 billion, up 21%, primarily benefiting from strong operating profitability. Our EPS was $1.75 for the quarter.

Adjusted EBITDA was $2.9 billion or 12.5% of revenue and $11.6 billion on a trailing 12-month basis. We generated $1.6 billion of adjusted free cash flow in Q3 driven by strong profitability and working capital discipline. Our Q3 adjusted free cash flow includes the impact of an approximately $400 million payment for a tax settlement, and our trailing 12-month adjusted free cash flow is now $7.7 billion.

We repaid approximately $1.1 billion of gross debt in the quarter and $3.5 billion year-to-date. And we are positioned to repay approximately $5 billion of gross debt in total in FY '20. We have now paid down $18.1 billion of gross debt since the EMC merger.

Shifting to our business unit results, Infrastructure Solutions Group revenue was $8.4 billion, down 6%. Storage revenue was $4.1 billion, up 7%, with strong growth in data protection and our industry-leading HCI business given our strong velocity with our VXRail solutions. Servers and networking revenue was $4.2 billion, down 16% due to a soft market, particularly in China and in large enterprise customers in the U.S. and Europe. As Jeff mentioned, ex China, server order revenue was down mid- to high single digits. We continue to be selective on larger deals when we see very aggressive competitor pricing. We are also focused on enhancing our coverage models and building sustainable, long-term customer relationships.

ISG operating income was $1 billion or 11.9% of revenue. Operating income percentage was up 140 basis points largely due to our business and geography mix.

Our VMware business unit had another good quarter with revenue of $2.5 billion, up 11%. Operating income was $717 million or 28.9% of revenue. On a stand-alone basis, Q3 VMware growth in revenue, plus the sequential change in deferred revenue, was 18% or an increase of 12%, excluding unearned revenue assumed from the acquisition of Carbon Black. NSX license bookings grew 50%, while vSAN license bookings grew over 35%. VMware closed the Carbon Black acquisition in Q3 and expects to close the Pivotal transaction before the end of Q4.
Client Solutions Group delivered strong Q3 revenue growth and profitability. Revenue was $11.4 billion, up 5%. Commercial revenue was $8.3 billion, up 9%, including double-digit growth in commercial desktops and workstations. Consumer revenue was down $3.1 billion, and it was down 6% as we continue to prioritize our commercial business and our focus on more profitable, higher-end consumer PCs.

CSG operating income was $739 million or 6.5% of revenue. Profitability was driven by component cost declines, commercial consumer mix and pricing discipline. Expect us to continue to balance revenue and profitability against market dynamics. As we have previously discussed, we are seeing and do expect operating margins to trend back to more historical norms given the changing cost environment.

Dell Financial Services originations were $2 billion, up 27%, with managed assets of $10.7 billion. And we continue to see interest in our flexible consumption solutions including Dell Technologies On Demand.

Turning to our balance sheet and capital structure. We ended the quarter with $9.4 billion of cash and investments after a $1.1 billion of gross debt pay-down and the approximately $400 million tax settlement payment. Our core debt balance ended the quarter at $35.9 billion, down almost $13 billion since the EMC acquisition. Net core debt ended Q3 at $29.6 billion.

We remain focused on maximizing free cash flow, and our capital allocation strategy is unchanged. Given our recent debt pay-down and refinancing activity, we have only $2.3 billion of core debt due in the next 15 months. And we will continue to look for additional opportunity to smooth our debt maturity profile and optimize our capital structure. We still expect to pay down at least $4 billion of gross debt next year, and are committed to reducing leverage to achieve investment-grade ratings.

Moving to guidance. We continue to monitor the macroeconomic and IT spending environments as well as the ongoing trade discussions between the U.S. and China. As Jeff mentioned earlier, we do see continued softness in large enterprise customers and in China. Based on Q3 results and the Intel CPU shortage Jeff mentioned, we now expect fiscal ’20 GAAP revenue of $91.5 billion to $92.2 billion, operating income of $2.9 billion to $3.1 billion and EPS of $5.83 to $5.98. We now expect our non-GAAP revenue range for the current fiscal year to be between $91.8 billion to $92.5 billion. The reduction of the range is principally due to the Intel supply dynamic.

With our strong profitability year-to-date driven by favorable component cost and disciplined pricing, we are raising the low end of our non-GAAP operating income and EPS guidance ranges. Our non-GAAP operating income range is now $10 billion to $10.2 billion, and our non-GAAP EPS guidance range is now $7.25 to $7.40. Our non-GAAP tax rate is expected to be 16%, plus or minus 1%.

We want to give you some insights into our preliminary thinking for fiscal ’21. We continue to see macro headwinds in China and softening client solutions demand post the Win 10 refresh. That, coupled with the Intel CPU supply constraints and the global macro environment, leaves us slightly more cautious on fiscal ’21 growth. We also expect the benefit of the fiscal year ’20 component cost deflation to wane as component costs are forecasted to be inflationary in fiscal ’21. Accordingly, our preliminary view is that operating income margins may trend closer to fiscal ’19 levels, and we are balancing investments in the business and adjusting spending as appropriate. We will provide an updated view of fiscal year ’21 expectations on our Q4 earnings call in February.

In closing, you should expect us to maximize our equity value to all shareholders through the 5 distinct levers we talked about at our business update: current operations, synergies, new opportunities, corporate structure and capital structure. Our model is focused on long-term profitable growth with the ability to adjust as needed based on market conditions. We are focused on growing faster than competitors in the industry, growing operating income and EPS faster than revenue over the long term and generating strong cash flow. You’ve seen that from us this year. As we maximize cash flow and profit, given the environment, you can expect us to adjust accordingly in fiscal ’21.

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) Erica, can you please introduce the first participant?

QUESTIONS AND ANSWERS

Operator

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

Wamsi Mohan - BofA Merrill Lynch, Research Division - Director

I appreciate the early fiscal '21 thought. So I was curious if you're anticipating any changes in the macro backdrop as you look at that. And if I could, your storage growth of 7% was very solid compared to a lot of peers. Can you talk about particular areas of strength in the quarter? And how much do you think was part of the bundled go-to-market and ELAs?

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

Hey, Wamsi, it's Tom. Let me start, and then maybe Jeff can jump in here as well, particularly on the storage and his view of the macro. As we think about fiscal '21, I just wanted to give you some -- or we wanted to give you some preliminary thinking as we see some of the current macro dynamics, right, principally some of the caution in the environment given the U.S.-China trade dynamics; the softness we've seen in large enterprise; consumption, particularly in servers; and the Intel CPU shortages causing some dynamics that are causing us to be a little bit more cautious than perhaps we would have been, say, 3 to 4 months ago. So we're going to work our way through that. We'll update you as we get through the end of Q4 and give you our view in our Q4 earnings call. But I thought it was appropriate that we give you some perspective as we think about next year, and we're clearly still in the midst of working our way through our planning process for next year.

And then, Jeff, maybe you could talk about storage and any other comments on the...

Jeff Clarke - Dell Technologies Inc. - Vice Chairman

Happy to. Yes, Wamsi, when I look at storage and highlights and things that we certainly are pleased to see, one is we referenced it in our opening remarks, VXRail and its 82% orders growth. We continue to see VXRail, combined with VMware Cloud Foundation, helping customers build out private cloud in this hybrid world that we look in. So that's certainly a highlight that we continue to see. The acceptance of our new data protection products has been quite good. The integrated products as well as the new data domain platforms are off to good, early starts, which to me is continued reinforcement. As we've modernized the portfolio and gotten increasingly more competitive, we're seeing the market respond accordingly.

And then the other areas that I'd point to is just the continued progress of our PowerMax platform and the new Unity XT. Both of them were growing in the double-digit zip code as we've looked at Q3 results, so very strong demand for our new products which is encouraging. The continued buildout of on-prem, private cloud, VXRail plus VCF are clearly things that are highlights of our storage business and storage demand.

Tom Sweet - Dell Technologies Inc. - Executive VP & CFO
Hey, Wamsi, it's Tom, one more comment I should have added. Clearly, as we think about component cost dynamics, we have enjoyed extraordinary deflation this year. And I think most of you know, we’ve talked about it from time to time, that our model is -- works extraordinarily well in a deflationary cost environment where we pass some of that costs through in terms of pricing, but we hold some of that cost goodness in terms of profitability. As you flip to a more inflationary environment, that clearly is not the dynamic. And I think part of what we wanted to do is make sure people are thinking through that component cost dynamic year-to-year as you set up for next year. So obviously, it's early yet. We'll continue to monitor the forecast and our thinking around that, but there are some dynamics working through on component cost as we think about next year.

Operator

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

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

Why do you think you're seeing such a bifurcation between continued strong storage segment and accelerating declines in servers? In recent quarters, it seemed like the China server business was the explanation, but now it looks like the unit weakness in servers has expanded outside of China. I'm just curious what the dynamics are that create such different trends between those 2 segments, and any comments around how the industry is flowing through component cost to pricing and if maybe that's a factor in the results.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman

Sure, Katy. This is Jeff. A couple of comments, and I know Tom will jump in with his thoughts as well. I think we've consistently identified large enterprise and large bids and China in our previous quarters this year as soft spots. Clearly, we saw unprecedented growth in the industry last year. That growth is being digested by the largest companies in the world. And we're seeing that primarily in that large enterprise in the United States and EMEA. China has been a headwind. We've called out, I think, consistently now for the last 3 quarters for sure, and that continues to be a headwind in that marketplace. There are also signs that we're encouraged by is the progress that we've made in our North America commercial. Our SB and MB sales forces have seen double-digit order growth in those areas in servers. So we're encouraged.

And I mentioned the growing buyer base in our opening remarks, too, I believe it was up 5%, which marks the fifth consecutive quarter of buyer base growth. It is a competitive market out there in the large bids. It's an aggressive marketplace from a pricing point of view. We're competing, but those bids are clearly competitive. And probably the other thing that is important to note is they're taking longer to close. The caution that we're seeing with our large customers is certainly being seen. And our ability to close transactions or how long it's taking to get that order closed would be another piece of color that I would add.

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

And Katy, it's Tom. I would -- Jeff sort of hinted at it, but we clearly see where component cost deflation is being used to price pretty aggressively right now. And we see that trend generally in the large bids across the globe and in China. And we've talked about in the past that we're going to be -- look, we're going to compete where we need to compete, and we clearly want to grow the customer base, but we want those customer bases to be, long term, the right type of customer for us in terms of profitability cycle that makes sense over time. And so we are being selective. And so that's just the dynamic that we're in right now.
I would also add, and Jeff hinted towards it, that our transactional server business is holding up reasonably well. So the weakness is principally in those 2 areas. I think when you get to storage, it's a different type of buying situation where you're generally putting a solution out there that is less price-sensitive in the sense of it's not tied to a commodity cost framework as much and it's more of an IP framework that you're selling in terms of capabilities and feature functionality of the storage solution. And it's a different type of -- it's a value sale solution, it's a value-selling process versus at times where it might be a more procurement-oriented process.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman

And we probably have the dichotomy of what's happening in the industry. We're in this data era. The amount of data created is not slowing. It's got to be stored, which is probably why we're seeing a slightly different trend from the compute side to the storage side. But I would point to VXRail, which is hyperconverged, where we bring compute and storage together in a modern 2-tier architecture, helping customers drive out their modern infrastructure build on-prem private clouds as a point of -- certainly that we're excited about given our position there and the opportunity that presents itself going forward.

Operator

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

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

I just wanted to understand this notion of incremental pricing pressure, pricing being passed along to customers. So perhaps you can help on the server side, what was unit versus ASP growth for server in the quarter? And when you talk about operating margins, I realize it's very preliminary in fiscal '21, is what you're anticipating that the benefit of component pricing will be increasingly passed along? Or are you actually more worried about prices staying where they are but component prices going up to the detriment of your margins? And perhaps in addressing that, you can talk about both PCs and servers and where you think you are in terms of halfway, 3/4 of the way, just starting in terms of prices being passed along, component prices being passed along in the form of lower prices to consumers.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman

That's a heck of one question. That is at least 4 parts that I got. So if I look at the trend of revenue and your specific question, Toni, about revenue unit trends, our revenue growth was greater -- or our revenue decline was greater than our unit decline, which I know the obvious question is that's an ASP implication. Interesting thing we see is continued progress on high-value workloads, which is driving higher DRAM content, higher SSD content. Both SSD and DRAM content was up double digits. We actually sold up the Intel CPU stack and servers at the same time, but it did not -- none of those 3 were enough to offset a modest ASP decline. So I think that answers the first 2 questions. Tom will jump in, in a second on the long-term implications.

What we're seeing in the marketplace, again, if you think of what we've done and the series of price moves we've taken over the first 3 quarters of this year, we have the product line, specifically servers, in price position. We're quite comfortable with the price position. We're in our historical norms, maybe on the slight -- on the high side of that but in our historical norms of price position in the marketplace. And you see the businesses that are very subjected to street price respond well, SB, MB, our North America commercial business, which are good indicators for us. In the largest business, as Tom and I just mentioned, that's where the most aggressiveness is and where we see, I guess, the commodity deflation being passed on to customers.
Tom Sweet - Dell Technologies Inc. - Executive VP & CFO

Yes. And as you think through, Toni, for -- it's Tom, for FY '21 -- and look, we're still looking at this, but if you take what Jeff just said, which is particularly for our PCs and servers, there are certain list price and street price frameworks that we want to run towards, as component cost deflation stabilizes, I'll say it that way, or flattens out, and then you start to get inflation, you have this dynamic where you ultimately will make decisions about how you price or how do you adjust pricing to adjust for those component cost input rises. If you decide to raise prices, we've talked about this in the past, in general, you only get about 60% of the price increase in any given quarter. So if you make a price increase in the quarter, you don't automatically move to that new price. So it takes time to digest price increases. And you're going to balance that relative to competitive dynamics in terms of where are you from a list position and a street price position such that you stay competitive.

And so in a component deflation environment, which is what we've been in this year, we've been able to adjust street pricing or adjust pricing downward, but the rate of deflation has been greater than that such that it has allowed us to capture some of that deflation in the form of incremental dollars to the bottom. As you move to an environment of inflation, that opportunity is not there. And then you're trying to balance pricing versus demand generation and ensuring that you stay in price position but yet protect the P&L as best you can. And so look, we've navigated through these cycles in the past. The model -- we'll adjust the model appropriate. But that's the dynamic we're working our way through, we're thinking about as we think about next year right now. This will get - - hopefully, we'll continue to get more clarity on potentially second half cost frameworks of second half fiscal year '21, as we go into FY '21. But our view right now is that the cost environment becomes inflationary as you go through the year, correct.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman

And then your question specifically to PCs, Toni, largely the commodity goodness in the first half of the year has already passed through in price. We've kept the product line and price position as well. It's -- largely, we've seen most of the cost of goods in the first half passed through. I do think we have to work our way through the supply shortages and what ultimately the market pricing will be. But there isn't a bunch of cost being held back, it is already pushed through in price.

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

We have seen in areas where there's partial shortage that obviously the pricing competitiveness -- or the pricing aggressiveness, I should say, subsides to some extent because you have a fixed amount of supply that you need to allocate in an appropriate way. So we'll just have to work our way through that as we go through the early parts of next year.

Operator

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

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

I guess I wanted to start by asking whether the trade situation has driven any kind of inventory increases. I know it's probably dominated more by shortages of CPUs but just wondering if you guys have seen any inventory
changes, particularly in the U.S. but maybe in other parts of the world as well as potential tariffs approach. And then I wanted to come back to this unit and pricing answer and just clarify whether that is inclusive of China. I guess it is. And I wonder, Jeff, if you could maybe comment excluding China, what happened to those prices and AUPs on servers.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman

The tariffs inventory, real simple, our inventory levels have not changed. We continue to run this business on very low levels of inventory. And to your point, it's the shortages particularly -- or specifically CPUs that are really driving our position of materials across our global supply chain, not tariffs whatsoever. In terms of unit price, we don't parse it out, excluding China, I certainly won't do that today. But it's the trend that I described. We're seeing, again, those transactionally oriented businesses respond to the price position in the marketplace. As I mentioned, our units were down as well, not as down as much as the revenue. We did see increases in content of DRAM and SSD as well as the CPU that I mentioned earlier. And I think that bodes well longer term as we think about content, we think about high-value workloads, our ability to offset some of the change in the cost environment going forward. If you recall, the front-end of this last server buildup, we had commodity increases across the board.

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

And by the way, Jeff, that was a server comment. That was...

Jeff Clarke - Dell Technologies Inc. - Vice Chairman

Yes, yes.

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

Right. That wasn't a PC comment.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman

Correct.

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

And I would add, Rod, just on the -- we have seen some elasticity in server transaction volumes, particularly in the small and medium business, that's responded well to the price position and price moves that Jeff and his team have done. It's just been a -- we've had, I would say, a pretty significant headwind on large enterprise bids and then particularly in the China business given some of the macro dynamics over there.

Operator

We'll take our next question from Aaron Rakers with Wells Fargo.
Aaron Rakes - Wells Fargo Securities, LLC, Research Division - MD of IT Hardware & Networking Equipment and Senior Analyst

I do have a product question as well. On the component side, you talked about, with regard to the client PC business, that SSD pricing would be up. I think, 20% sequentially in the calendar fourth quarter and that DRAM pricing would start to trend higher into 2Q of 2020. Can you give us the same kind of framework or commentary of how you're seeing those trends specific to the server or enterprise SSD as well as the server DRAM market? How are you thinking about those dynamics as you kind of give the commentary with regard to fiscal 2021? And then any update on the midrange next platform on the storage side, when is that expected to start to ship and impact the storage business?

Jeff Clarke - Dell Technologies Inc. - Vice Chairman

Sure, Aaron. And real quickly, the NAND trends and DRAM trends that I mentioned were across all of our NAND purchases and DRAM purchases. So industry analysts and experts have projected the cost that I referenced earlier, the 20% of SSDs. Now DRAM, I believe I said Q2 of calendar 2020. That's across our broad purchase of both server components as well as PC components. And in the midrange, we're still on track. So the commitment I've made in a number of these calls that we will have the product completed by the end of the fiscal year, and it will be released. We're pretty excited about that, particularly with the momentum we've seen on Unity XT, which is the bridge from the old Unity product, a performance increase -- a significant performance increase that we launched over the summer that takes us to the new midrange product out -- at the end of the fiscal year. We like what we've done. Certainly, we've talked a little bit about the feature set. It's a modern stack containerized capability. It's a modular design, without getting into predisclosing what the exact product is. We're excited about what it means, we have the right bridge strategy and we'll be able to help our customers migrate from their current technology to our new midrange storage product.

Operator

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


I wanted to see if we could double-click on the dynamics of what's happening in China, specifically set some context for us how much of the business comes from China. And then in terms of what's going on there, how much do you attribute to their weaker economy? And how much do you attribute to, let's call it, a political aspect of maybe not buying from Dell because you're a U.S. company, in which case, one is resolved by trade, the other is dissolved by -- resolved by a better economy?

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

Hey, Simon, it's Tom. Let me just give you some context here, right? So from a size perspective, we've said this in the past that the China business unit is sort of high single digits in terms of -- as a percent of revenue of the total company. So you can do sort of rough math on that. As we think about the demand environment in China, and I'm not going to parse it for you whether what we -- our belief, as we look at the business, is that there's a couple of dynamics happening. One, there is an overall sort of macroeconomic softening that's happened in the country. We have seen that in elements of the China business. It's hard, and I'm not under any ability to sort of say some
of that is because of some of the more political dynamics, I can't really call that. What we're trying to do right now is ensure that we've got the China business properly framed such that when the Chinese economy comes back into growth mode or into more -- a stronger mode that we can take advantage of the opportunities over there and continue to supply our customer needs over there.

So look, it's not a -- it's a tough environment. We've done a number of actions to set that business on a framework that makes sense for us. We'll continue to optimize as -- to the extent we can over there. And we're in China for the long term, but we have to make sure that the business model makes sense relative to the opportunity.


Do you feel as if you're losing share or holding share in China?

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

We -- there are -- it's a mixed bag. We are taking share in PCs. We've taken share in storage. We have deliberately walked away from a number of large server deals over there where the pricing just absolutely made no sense to us, I'll say it like that.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman

With the hyperscalers.

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

Yes, principally with the hyperscalers over there. And so we have lost server share in China. And part of that was by design -- most of it was by design. At the same point in time, what we've asked our Chinese team to do is say, hey, look, we want you to build a sustainable long-term model around a broader set of customers, of building the customer base, to drive a more -- what we would call a more healthy environment in terms of the server framework, server business over there.

Operator

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

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

I guess 2 questions for me as well. Jeff, first for you, how should we think about the broader storage market given all the commentary you made in fiscal '21? And perhaps you can touch on both. What do you think the end markets are going to do? And does Dell's share gain narrative become more powerful in fiscal '21 given some of the comments you made on the unified midrange offering earlier?

Jeff Clarke - Dell Technologies Inc. - Vice Chairman
Yes. If we look at what the industry analysts are projecting for next calendar year, I believe the storage -- external storage forecast is roughly minus 1%, I think, is the aggregate consensus of all of the industry experts and analysts there. Look, my job is to do better than that, outperform the marketplace and take share. We're going to do that with the industry's broadest storage portfolio from our classic 3-tier storage architecture, so primarily arrays with high end, midrange and the entry-level products. We have the advantage in the high end of the marketplace with our PowerMax product. Our Unity XT product, as I mentioned earlier, is doing well, growing double digits. It's a bridge to the new product that will be out next year, as I mentioned. We've made progress with the entry-level product. Our broad storage portfolio moves into the areas of data protection, which the new integrated data protection appliance and the new data domain products are off to a good start as they've been refreshed. Then we have the HCI and CI portfolios of PowerOne that I just mentioned, a leader in the converged infrastructure category. And then we've certainly been the market leader in the fast-growing HCI space.

So with that broad portfolio now largely refreshed and modernized, I'm optimistic that we can outperform the marketplace as we head into next year. That's certainly the targets that we have in place. You combine that with the sales force buildout that we've put in place over the last 2-plus years, more storage sellers, more storage specialists. We've made progress in what we call the enterprise acquisition accounts. That business is growing nicely. So I'm optimistic that we have put the right plans together with the right portfolio, the right investments to grow our storage business at a differentiated rate to the marketplace. I'd circle back, we've largely done that in the last 2 years. We've taken 375 basis points of share. And over the 2-year period, we've largely grown the external storage business in a market that's slightly down.

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

Got it. That's really helpful. And I guess, Tom, I just want to make sure I heard you correctly initially. You said fiscal '21 operating income margin will be closer to fiscal '19. I think that's the comment you made. Is there a way to think about what does free cash flow does in that narrative? And maybe you could qualitatively talk about what are the puts and takes of free cash flow in fiscal '21 versus fiscal '20 for you guys.

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

Yes. Hey, Amit, what I said was our preliminary view is that operating income margins may trend closer to fiscal '19 levels. And principally, because as you think about -- and this will also depend obviously on what ultimately happens with the component cost environment. But right now, we expect it to be inflationary. We don't forecast free cash flow externally. I should say. We do forecast it internally, clearly. So look, it will be a function of -- free cash flow is always a function of profitability and working capital and other dynamics within the company. And so it's our job to optimize working capital. It's our job to optimize free cash flow. More importantly, you heard me say on the call that, hey, we're committed to the $1.5 billion -- essentially the $1.5 billion of debt pay-down in Q4 to get to the $5 billion target we've laid out. We've paid $3.5 billion of debt down so far year-to-date and that we're committed to the $4 billion of debt pay-down next year. And even as we run the sensitivities around that, given what we know today, that all looks within the framework of that we're comfortable with. So we'll continue to update you guys and give you further thinking on that as we -- come back at the end of Q4, but that's the framework we think of right now.

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Operator

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

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Shannon Cross - Cross Research LLC - Co-Founder, Principal & Analyst
Just one question. I wanted to go back to PCs. You indicated that the shortages from Intel are going to impact the current quarter. And then you talked a bit about, I don't know, perhaps lingering pressure in 2021. So I'm just kind of curious as to what you see the trajectory like. And do you expect -- I think HP just indicated they expect a bit of a pushout in terms of -- or continued, I guess, stronger demand than maybe one would have thought in the coming year because of some of the mix dynamics and pressure from Intel. I'm curious as to what you're seeing.

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

Yes, Shannon. Let me at least try to give a couple of data points. One, and I think we've talked about this, we've largely mitigated the supply challenges to date, and we think our direct models allowed us to do that with the speed and flexibility that it gives us to adjust to the outputs out of the factory. Clearly, with what we said earlier, there's been a change in Q4, and we're dealing with that real time. History would suggest if we can't fulfill demand in the industry that we will see it spill over into the coming calendar year, particularly with Windows 10. We're roughly 2/3 through the refresh cycle. And to the point there's a delay with that, they're going to spill over into the following calendar year. Perhaps, maybe another way to say it is we think that elongates the cycle. We've talked about we think it spills over into the first half already. I think there's just another validation that it will spill over into the first half of next year given the continued or increasing challenges with Intel supply. So that's how we've certainly look at it. We're certainly dealing with the information that we have real time and making the adjustments accordingly.

**Operator**

We'll take our next question from Andrew Vadheim with Wolfe Research.

**Andrew Vadheim - Wolfe Research, LLC - Research Analyst**

I had one on margins. So if we put aside products gross margin expansion and turn over to services, this is the second consecutive quarter of services gross margin being around 100 to 150 bps lower than where it was tracking last year through Q1 of this year. Can you just walk through the puts and takes on that line item and whether anything structurally has changed?

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

Well, there's nothing that has structurally changed on services margin. The only thing that -- and I don't have the data right in front of me. I would offer you a couple of comments. One is overall, we've seen actually good attach rate on services -- our services offerings in general. And in fact the content rate on our -- on some of our products has increased. So we're pleased with that content rate. As we think about the margin dynamic, the comment I would offer you is principally whether -- we're putting a lot of that services profitability under the balance sheet that's getting -- building up the deferred revenue, so you'd have to think about -- of that dynamic. But there's nothing structurally that's happened in the business or how we're marketing or positioning the services that would call out any significant structural issue.

**Operator**

We'll take our next question from Jeriel Ong with Deutsche Bank.
Jeriel Ong - Deutsche Bank AG, Research Division - Research Analyst

I just want to understand the bridge from -- for fiscal '19, fiscal '20, back to fiscal '21, which is going to be similar in fiscal '19 because of operating margin. Two ways to think about it, I'll let you kind of answer it. Number one, in terms of the downshift in margins, is it -- what portion is this revenue or perhaps component pricing mix driven to drive that lower margin? Or another way to think about it would be segment-based, which would be how much of the margin degradation year-on-year is going to be ISG versus CSG versus other business.

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

You're talking -- hey, it's Tom. You're talking about fiscal '20 to '21? Is that the comment -- is that the question?

Jeriel Ong - Deutsche Bank AG, Research Division - Research Analyst

Yes. Yes, that is -- yes, that is the question.

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

Well, I think you got to go back to what we think the drivers are around a potential -- sort of potential margin pressure or operating margin pressure next year. We have been pretty vocal throughout this year, principally in the last couple of quarters on these calls, around the profitability profile of our CSG business in that it has trended higher than normal given some of the component cost deflation we've seen. And so a significant majority of the margin dynamic year-to-year, assuming that component costs move from deflation to inflation, which is the forecast that we have right now, will impact the profitability profile of our CSG business back towards historical norms. So I would think about most of that pressure being in -- that dynamic is a big driver of some of the profitability -- potential profitability shifts year-to-year. You have a little bit of that dynamic within the server because again, you got to think about which LOBs are more commodity cost sensitive in terms of pricing dynamics. And those 2 LOBs tend to be our most sensitive impact -- the ones that are impacted the most.

Jeff Clarke - Dell Technologies Inc. - Vice Chairman

Well, they are. And Tom, I think you hit it, is if you look at the deflation in calendar '19, our model generally captures that more quickly and is advantaged when we have that deflation. And I think you see it, what was our beginning of the year expectations for profit. So we're repeating that, too, today. And as Tom said, we have a deflationary period coming, and those businesses will perform back towards their historical norms.

Operator

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

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

You guys have talked about China several times. But wondering if you could back up and talk about the demand environment across other geographies around the world. And also, I just wanted to clarify if you think the macro overhang has actually gotten worse versus where we were in the second quarter or if the drag is more kind of consistent over the last, let's call it, 90-plus days or so.
Tom Sweet - Dell Technologies Inc. - Executive VP & CFO

Yes, look, it's Tom. Let me -- I think the macro overhang is reasonably consistent, maybe slightly worse, but it didn't fall off the cliff or anything like that. But we are just seeing continued caution in the environment, continued softness in the environment. We've talked about it a couple of times, but principally in server, we have seen softness in large enterprise, slowness in procurement cycles -- elongation of procurement cycles, I should say. Critical projects are still getting done, but they seem to be taking longer from a procurement cycle. And I think that's just a function of sort of the macro dynamics that many companies see them -- are in, in the sense of trying to navigate what is a little bit of an uncertain macro political, economic environment right now. And so our perspective is there's a bit of caution out there that we're seeing. Our sales organizations are out there selling every day. So we've got the broadest reach in the marketplace. We are being disciplined on pricing. And so I'm not chasing and driving deals that just don't make economic sense to me over the long term. Though there is some level of that happening within our business.

As we step back and think about your question around G6 and thinking about the various geographic dynamics, we would tell you that in general, the U.S. remains reasonably healthy, right? Yes, there's some large -- there's some softness at large on the large enterprise procurement, in servers in particular, but our commercial North America business, our small and medium North American businesses are doing quite well. We're pleased with the progress. We have seen some softening in Europe, Western Europe in particular, in Q3. I think Japan continues to be strong for us. India continues to be reasonably strong. China's been soft, as we've talked about. Australia and New Zealand has been soft. And so -- and Brazil has been strong. So I mean if you just bounce around the globe and some of the major economies, it's a little bit of a mixed bag, which is, I think, the message we're trying to send you guys, which is it's a bit of a mixed bag.

Look, it's our job to navigate through all of that and drive the business forward, and I'm confident we'll do that. And that's the navigation that we had to get done here in Q4 on into next year. So I think from an overall positioning, I think we're well positioned. We've got the broadest product and solution portfolio in the market. Customer receptivity to our offerings is high. So it's a matter of us going out there and making sure that we're having the appropriate conversations with our customers every day and helping them drive to the outcomes that they desire.

Rob Williams - Dell Technologies Inc. - SVP of IR

All right. Good. Well, thanks, Tom, and thanks, Matt. As a reminder, we'll be at the Wells Fargo Summit in Las Vegas and the Bank of America Leveraged Finance Conference in Boca Raton on December 3. We'll be at Crédit Suisse in Scottsdale on December 4. Then the following week, we'll be in New York at the Raymond James Conference on December 10 and the UBS Conference on December 11. And finally, we'll be at CES in Las Vegas in January. So thanks for joining us today, and we hope you all have a great Thanksgiving.

Operator

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