GOOD AFTERNOON, AND WELCOME TO THE FISCAL YEAR 2022 FIRST QUARTER RESULTS CONFERENCE CALL FOR DELL TECHNOLOGIES INC. I'D LIKE TO INFORM ALL PARTICIPANTS THAT THIS CALL IS BEING RECORDED AT THE REQUEST OF DELL TECHNOLOGIES. THIS BROADCAST IS THE COPYRIGHTED PROPERTY OF DELL TECHNOLOGIES INC. ANY REBROADCAST OF THIS INFORMATION IN WHOLE OR PART WITHOUT THE PRIOR WRITTEN PERMISSION OF DELL TECHNOLOGIES IS PROHIBITED. [OPERATOR INSTRUCTIONS]

I'D NOW LIKE TO TURN THE CALL OVER TO ROB WILLIAMS, HEAD OF INVESTOR RELATIONS. MR. WILLIAMS, YOU MAY BEGIN.

ROBERT L. WILLIAMS - DELL TECHNOLOGIES INC. - SVP OF IR

THANKS, JERMIRIA, 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 MATERIALS ARE AVAILABLE ON OUR IR WEBSITE. THE GUIDANCE SECTION WILL BE COVERED ON TODAY'S CALL.

DURING THIS CALL, UNLESS WE OTHERWISE INDICATE, 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.
Additionally, I’d like to remind you that all statements made during this call that relate to future events and results 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 filings. We assume no obligation to update our forward-looking statements.

Now I’ll turn it over to Jeff.

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

Thanks, Rob. Hi, everyone. Thanks for joining us today. We are coming off a strong first quarter and a successful Dell Technologies World, where we connected with more than 60,000 customers, partners and stakeholders. We made important announcements on APEX, our edge strategy, and social impact and sustainability commitments, and the response was fantastic. We are energized by the positive feedback on our strategy, innovation and opportunity.

One of the real silver linings of last year is that digital transformation has been accelerated. Our world is running on data highways now, and we’re experiencing everything technology makes possible, deeper, data-driven insights, connectivity and even a deeper human connection. Technology is no longer the IT department. It’s the entire organization. It’s how you enable everything to deliver better business outcomes.

And customers are looking to Dell Technologies as their strategic partner to help run their business, deliver their outcomes, capture their opportunities in the data era. For example, a large Fortune 500 retailer made VxRail and VMware Cloud Foundation the hybrid cloud standard for workloads in their data centers. Another example is Honeywell, who is helping its customers transform day-to-day business operations through Software-as-a-Service solutions for the industrial sector. Built on Dell infrastructure, Honeywell Forge Connect is the edge interface for Honeywell Forge Enterprise Performance Management.

Turning to the financial results. We started the year strong, delivering record revenue in Q1 of $24.5 billion, up 12%. These results are driven by the "do anything from anywhere" economy where technology enables connectivity and outcomes for all of us. Instead of going to work, school, entertainment or shopping, it all comes to us through our PCs. That need for connectivity was demonstrated in the record demand last year and has continued into this year. Our Client Solutions Group delivered record revenue for the first quarter of $13.3 billion, up 20%.

In our Infrastructure Solutions Group, we are seeing improved demand as customers invest in the solutions they need to power our do-from-anywhere world. The improvement we saw at the end of last year continued into Q1, with revenue growing 5% to $7.9 billion. We saw growth in Q4 for servers and midrange storage, and the momentum continued into Q1 with PowerEdge orders up 7% and midrange storage orders up 23%.

Our VMware business also had a strong quarter with revenue of $3 billion, up 9%. Our partnership continues to expand and our ongoing strategic relationship has been formalized with the commercial agreement announced last month. For example, we have a framework in place to identify new areas of first and best joint innovation. Our unique partnership will continue to deliver highly differentiated, integrated solutions that are multi-cloud and accelerate digital transformation.

We are pleased with the quarter, and we are even more excited about the opportunities ahead and the long-term value proposition for Dell Technologies and our stakeholders. With a $4 trillion total IT market, we are only servicing a portion of that total surface area today. Our value creation framework is focused on 4 key areas that expand that surface area or serviceable market. We do that by focusing on our core markets, the broader ecosystem, new growth opportunities, and our corporate and capital structures. I'll cover the first 3 today, and then Tom will cover the fourth.

Our strategy begins with growing and modernizing our core businesses. Our serviceable or addressable market is expanding. In 2019, the serviceable TAM for the broader client ecosystem was approximately $600 billion. And looking out to calendar year 2025, it jumps to a projected $750 billion. This expansion in TAM is driven by increased systems per household, faster refresh rates with higher notebook mix, and investments in a hybrid and remote workforce. Our investments are focused on making the PC more personal and intelligent. But it’s just not about the PC. It’s about providing technology to deliver an experience to customers that allows them to be connected, productive and effective no matter where they are, and that's increasingly about software.
A few recent examples. We continue to innovate with our built-in AI software, Dell Optimizer, that learns, responds and improves the way you work. We recently updated Dell Hybrid Client that gives users access to their applications and data whether delivered from the public cloud, private cloud or on the device. And we introduced the new SafeShutter on selected devices, the industry’s first automatic webcam that knows when to open or close by syncing to your video conferencing applications. It’s all of these things combined, devices, software, services and peripherals and a higher profitability profile that have us excited about the future opportunity.

The serviceable TAM for our infrastructure business is also growing, from approximately $150 billion in 2019 to a projected $200 billion by 2025. That means growth in areas like servers, storage and networking where we are strong, and growth in areas like hyperconverged infrastructure, where we are innovating for the future.

Just a few weeks ago, we launched software updates to PowerStore, improving workload performance by up to 25%. By automating data processes, we are saving customers money while lowering latency by 15%. We also introduced the cost-effective, entry-level PowerStore 500 to the lineup. PowerStore now serves all midrange price bands. PowerStore is the industry’s first modern, midrange storage architecture in a decade. It’s a container-based, micro-service software, allows for rapid deployment of new capabilities with no disruption. It continues to ramp faster than any new architecture we’ve ever released and accelerates our opportunity in midrange storage.

We recently launched a new line of AI-enabled PowerEdge servers that help customers meet the challenge of digital transformation with a secure infrastructure that supports modern workloads.

We are leading with innovation and taking share where we are strong, but we also know long-term success means doing more than just winning in the consolidation. It also means delivering a leading customer experience, including modernized consumption. This is where APEX comes in, to deliver the scale of the cloud with the ease of as-a-Service. It’s a critical component to how we modernize and grow our core businesses, grow private and hybrid cloud, and win the edge.

Building on our long history of offering IT as-a-Service, earlier this month at Dell Technologies World, we launched the new APEX portfolio offerings, Data Storage Services, Cloud Services and Custom Solutions. APEX helps customers simplify digital transformation by increasing IT flexibility, agility and control via a cloud-based service model. We are seeing increased customer interest. Customers like GE are turning to Dell for an as-a-Service approach that assists the industrial giant in delivering solutions that make the world work more efficiently, reliably and safely; and Magellan Health, looking for better control of their infrastructure to help serve patients faster and more effectively.

And we’re building the technology ecosystem of the future. We are innovating and integrating with VMware and our partner ecosystems to create an automated, intelligent infrastructure for 5G and the data era. This includes our better-together solutions with VMware that customers have embraced, such as VxRail, VMware Cloud on Dell EMC, VeloCloud SD-WAN as well as security and end-user computing. With Dell Technologies and VMware, customers have consistent infrastructure and operations from the public cloud to the private cloud, colocations and the edge.

It’s estimated that 75% of data will be processed outside of a traditional data center or cloud by 2025, and that data will be generated in the real world at the edge. One of the ways we’re helping customers make decisions at the edge in real time is with our Streaming Data Platform. This is an open platform that offers powerful real-time analytics at the edge with a smaller footprint. By putting compute, storage and analytics at the edge, where the data is created, we deliver insights in real time and create new opportunities for businesses.

We also continue to support customer choice through an ecosystem of value-added partnerships like what we’re doing with PTC ThingWorx for smart manufacturing at the edge and with Equinix for hybrid cloud and as-a-Service offerings. And next month, we’ll announce an open network ecosystem that brings together infrastructure technology, partners and services to create a more agile and profitable ways for communication service providers to transform their operations and modernize to an open, cloud-native 5G networks. Together with VMware and our partner ecosystem, we are the hybrid and multi-cloud platform for the digital future. And we’ll deliver it all through a consistent cloud model and as-a-Service with APEX.

As we think about future areas of growth, we’ll leverage our leading capabilities, our relationship with VMware and the broader partner ecosystem to capitalize on new large addressable markets and emerging technology spaces, multibillion-dollar markets today that are projected to grow
exponentially by 2025. Here, we will pursue logical and closely adjacent opportunities where we have the unique opportunity to win, in areas such as hybrid cloud, edge, telco, as-a-Service and data management to drive high-value growth.

We are confident in our ability to drive high-value growth for 2 reasons. One, our differentiated strategy: grow and modernize the core with software; leading with our unique VMware partnership, innovate, integrate and partner to build the technology ecosystem of the future; win the next technology frontier at the edge; deliver the scale of the cloud with ease of as-a-Service with APEX. And two, our competitive operational advantages: our direct sales force and customer intimacy, our global services capability, Dell Financial Services, and industry-leading scale and supply chain.

Combined, we have a more focused business with the right formula to consistently deliver annual revenue growth in the GDP or better range over the long term with strong profitability and predictable cash flow. It's an incredible time to be in the business of delivering technology solutions that deliver experiences, insights and outcomes. We are optimistic about the opportunities ahead.

Before I turn it over to Tom for a closer look at the financials, a quick comment on the global supply situation that extends well beyond IT hardware. As we have mentioned, the pandemic accelerated the adoption of digital technology in every industry. And when coupled with an improving global economy with greater demand for everything, there is an overall shortage of semiconductors. We are executing our strategy as we work through this environment, just as you've seen us do before and which you've come to expect from us.

Now over to Tom.

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

Thanks, Jeff. I am pleased with our performance as we started the year strong with double-digit revenue growth, operating income growing faster than revenue and strong cash flow generation given the strength in the business.

Revenue for Q1 was a first quarter record at $24.5 billion, up 12%, driven by growth in all 3 business units, especially CSG and an improving ISG business. Gross margin was $8 billion, up 9% and 32.7% of revenue. Gross margin as a percent of revenue was 70 basis points lower, primarily driven by a 370 basis point revenue mix shift to CSG.

Operating expense was $5.3 billion, up 3% year-over-year. We are continuing to prudently manage our expenses. But as we talked about last quarter, some costs are coming back into the P&L. Operating income was also a first quarter record at $2.7 billion, up 26% and 11.1% of revenue. We saw improved profitability in all 3 segments, led by CSG. Given the progress we've made on paying down debt, our interest expense was down approximately $162 million, contributing to an even stronger growth of 59% in consolidated net income to $1.8 billion. Earnings per share was $2.13, up 59%.

Our recurring revenue, which includes deferred revenue amortization, utility and as-a-Service models is approximately $6 billion a quarter, up 12% year-over-year. And our remaining performance obligation is approximately $42 billion, up 15%, which includes deferred revenue plus committed contract value not included in deferred revenue. The growth was driven by a solid performance in hardware and software maintenance and custom as-a-Service solutions. Excluding VMware, Dell's remaining performance obligation is approximately $32 billion, up 18%.

Turning to the business units. Our Client Solutions Group delivered another quarter of outstanding results despite industry-wide supply chain challenges. CSG revenue was up 20% to $13.3 billion, driven by ongoing high demand for remote work and learning solutions along with gaming systems.

Commercial revenue was up 14% to $9.8 billion. We saw double-digit orders growth for Latitudes, Precision systems and Commercial Chromebooks. And we are starting to see improved demand for desktops as orders for our commercial desktops return to growth.

Our consumer business delivered revenue of $3.5 billion, up 42% as demand remains strong from consumers looking for upgraded experiences in today's world of digital entertainment and e-commerce. On an orders basis, our XPS notebooks were up 21%; Alienware notebooks were up
76%; and our consumer online business was up 58%. And we are riding a wave of growing ASPs in the consumer business as more consumers are choosing high-end systems.

CSG operating income was up 84% to a record of $1.1 billion and was 8.2% of revenue. We saw better-than-expected profitability primarily due to strong shipments, a stable pricing environment and some component cost deflation.

We also had a strong quarter for client solutions software and peripherals and services. This highlights the points Jeff made earlier about the broader opportunity for our client business as we innovate across the ecosystem to deliver an enhanced experience for our customers looking to work and play effectively from anywhere. This total solution focus, along with our differentiated competitive advantages and strategy, have enabled us to deliver margin expansion over the last 5 fiscal years. Over that period, CSG revenue has grown at a 7% CAGR while operating income has grown by a CAGR of 18%.

Moving to ISG. We are encouraged by the positive momentum we’ve seen in this business over the last 2 quarters. For Q1, revenue was up 5% to $7.9 billion, driven by an improving demand environment for compute and building momentum in storage. We believe demand will continue to improve as we move through the year as customers accelerate their IT investments with focus on hybrid cloud solutions.

Servers and networking revenue was $4.1 billion, up 9%, as we saw increased demand for infrastructure compute across our customer base.

Storage revenue was $3.8 billion, flat compared to last year. Highlights for the quarter were hyperconverged infrastructure and midrange, each up 23% based on orders, as VxRail and PowerStore continued to deliver strong growth. Storage buyers were up 12%, driven by PowerStore.

ISG operating income came in at $788 million or 10% of revenue, which was up 30 basis points as we benefited from continued operating expense discipline and an improving demand environment.

We have a significant presence with many of the leading cloud-based companies in the world. In fact, we provide infrastructure to nearly 80% of the largest cloud service providers in the world. And looking at our top 1,000 ISG customers, demand from SaaS companies, cloud-hosting companies, telco, consumer webtech and fintech companies was up double digits over the trailing 12-month period and currently accounts for nearly 30% of orders from that top 1,000 customer set.

The VMware business unit also performed well, delivering revenue of $3 billion, up 9%, and operating income of $841 million or 28.1% of revenue. Based on VMware’s stand-alone results, subscription and software as-a-Service revenue grew approximately 29%. The largest revenue contributions were from VMware Cloud Provider Program, modern applications, and end-user computing.

Geographically, we have seen an encouraging rebound in demand across most of the countries and regions in which we operate. In our top markets, the United States was up 9%, China was up 36%, and Germany was up 19% based on orders.

Dell Financial Services first quarter originations were $1.9 billion, up 5%, driven primarily by continued strength in our Americas business. DFS ended the quarter with $12.7 billion in total managed assets, up $1.4 billion year-over-year. We had a good quarter for our APEX Custom Solutions, Flex on Demand and Data Center Utility, where we saw bookings of $164 million. These offerings are key and will continue to contribute to our as-a-Service and growth in our remaining performance obligations. And as we talked about at Dell Tech World, APEX is the next evolution of what we’ve been building on for decades, aligning us even more closely with customer outcomes and results. The pace of adoption will be driven by customer acceptance, but we are seeing increased interest. We believe it will drive incremental revenue growth in the future.

Turning to our capital structure and balance sheet. We had a strong quarter of cash flow generation and continued our focus on deleveraging. We generated positive cash flow from operations of $2.2 billion despite typically using cash in our first quarter due to P&L seasonality and bonus payouts. On a trailing 12-month basis, cash flow from operations was a record $14.4 billion. And excluding VMware, it was $10.1 billion. We have a history of generating strong cash flow with our core business averaging more than $6 billion of cash flow from operations annually over the last 2 years.
Cash and investments at the end of the quarter was approximately $15.9 billion and $10.1 billion for Dell, ex VMware. Adjusted EBITDA was $3.2 billion, up 24% at 13.2% of revenue. For the trailing 12 months, adjusted EBITDA was $13.4 billion, up 13%. During the first quarter, we paid down approximately $1.5 billion of debt, paying off all of our fiscal year ’22 maturities. Additionally, we paid $1 billion of the margin loan earlier this month for a total debt paydown of $2.5 billion year-to-date.

Our debt balance now stands at $47.2 billion, and that includes DFS-related debt of $10.2 billion and subsidiary debt of $4.8 billion. Our core debt ended the quarter at $27.9 billion, and our core leverage ratio is now approximately 2.3x adjusted EBITDA.

Given our strong Q1 cash flow performance, ending Q1 cash balances and the expected VMware dividend proceeds of approximately $9.3 billion to $9.7 billion, we are increasing our full year debt paydown target to at least $16 billion for fiscal year ’22.

Our expectation is that once the spin of VMware is finalized, we will be upgraded to investment-grade by all 3 credit rating agencies. As a reminder, following the announcement of the VMware spin, the 3 rating agencies updated our outlooks to credit watch positive or put our credit rating under review for a potential upgrade to investment-grade ratings. After achieving an investment-grade corporate family rating, we will target a core leverage ratio of 1.5x adjusted EBITDA. Given our healthy balance sheet and strong free cash flow, along with the anticipated Boomi proceeds, there will be opportunity for a more balanced capital allocation policy, including shareholder capital return, investments to grow the business and value-enhancing M&A. We will have more to say on this topic as we get closer to the close of the VMware transaction.

Now to our outlook. From a macro point of view, the pace of the global economic recovery is progressing with regional and country-specific puts and takes as COVID waves continue to impact many countries and the pace of global vaccine administration progress is uneven. Additionally, the pandemic drove acceleration of digital transformation across multiple industries, and supply has not kept up with demand for certain components. Geographically, North America, China and many countries in Europe are seeing stronger economic recovery and related IT spending.

For revenue, it would be appropriate to flow our Q1 revenue upside through your full year models after considering the comments I just mentioned. It’s clearly a fluid environment. For Q2, our normal sequential revenue increase is about 6%. We are seeing progress on the economic front. But given ongoing supply constraints particularly impacting CSG as well as VMware’s stand-alone guidance, we expect Q2 revenue to be slightly below our normal sequential pattern over the past few years.

For Q2 operating income, there’s a few items I’d call out. As we talked about on prior calls, we had some costs coming back as we reinstated a number of employee-related benefits in Q1, most notably merit and promotions. I’d also remind you that the VMware and Dell core businesses are investing for long-term growth. We will see a mix shift within CSG in Q2, driven by normal seasonality of stronger education PCs and Chromebook sales. The component supply situation remains constrained, and we expect component cost to be inflationary in Q2. Factoring in these items, we expect operating income to be down low to mid-single digits sequentially on an absolute dollar basis.

Below the operating income line, we will continue to benefit from lower interest expense. For non-GAAP tax rate, you should assume 17.5%, plus or minus 100 basis points. In addition, keep in mind the majority of the activity for the new $16-plus billion debt reduction target will take place in conjunction with the expected close of the VMware transaction in calendar Q4.

In closing, we have a set of durable competitive advantages that we believe lead us to a differentiated growth strategy for GDP to GDP plus revenue growth, strong profitability and predictable cash flow. We are focused on maximizing long-term value creation for all aligned shareholders by continuing to profitably grow and modernize our core markets, adding value beyond hardware and transforming our business through APEX. We will leverage our market reach and philosophy of customer choice to bring a broad set of technology solutions to our customers through our first and best alliance with VMware and our broader partner ecosystem. We will pursue adjacent high-growth opportunities like hybrid cloud, telco, edge and data management through organic and potentially future inorganic investments. And we have been deliberate in our corporate and capital structure optimization with the announced VMware spin and Boomi transaction, along with the sale of RSA last year. We will continue to evaluate our structure and capital framework as we go forward.

With that, I’ll turn it back to Rob to begin Q&A.
Robert L. Williams - Dell Technologies Inc. - SVP of IR

Thanks, Tom. Before we start the live portion of our call, I'm sorry to share that Jeff will not be able to join us for the Q&A session. Regretfully, he had an emergency in his extended family this afternoon. (Operator Instructions) Jermiria, can you please introduce the first question?

Questions and Answers

Operator

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

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

On the supply constraint side as well as higher memory costs going higher and returning back to work, can you give us some color on that as far as your orders, your books? Are corporations ordering different things post-COVID than pre-COVID? And the component cost of memory, are you able to pass those through? Or is there like a 1-quarter lag?

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

Jim. So look, I mean, as it relates to component costs, I'd give you the following thoughts, right? So obviously, given the -- what the environment is with the pace of recovery, the supply situation has not kept up with the demand environment as we think about the need for semiconductors. And that's an industry-wide issue and clearly an issue that the technology industry is dealing with.

Look, we do expect and -- we do expect that component cost our inflationary in Q2 and probably are going to be inflationary in the second half as we think about it today. And that's principally coming out of displays, DRAMs and NAND. We're not seeing customers at this point in time adjust their configuration frameworks, if you will, in terms of the amount of memory or other types of how they're loading or configuring their systems. That has been a pattern we've seen in the past though with past memory cost or price increases in certain components. So it's clearly something we're watching.

I do think as it relates to pricing, it is our intent that we will price the input cost increases as appropriate, keeping a thoughtful eye on the market and keeping -- making sure we're in a competitive position. So that's sort of the state of play at this point.

Operator

Our next question is with Wamsi Mohan with Bank of America.

Wamsi Mohan - BofA Securities, Research Division - Director

Tom, your guide of low to mid-single-digit decline in operating income for next quarter, as we sort of look at that, that would put you roughly flattish for operating income year-on-year, but there are these inflationary pressures that you spoke about in the second half. How should we think about the balance of operating leverage that might kick in because of a recovery in ISG versus these inflationary costs? Is it correct to extrapolate what you're talking about in 2Q further out in the year?
**Thomas W. Sweet** - Dell Technologies Inc. - Executive VP & CFO

Well, look -- Wamsi, thanks for the question. I think about it like this. One, I'm really not going to get into the back half of the year other than let me give you a couple of thoughts around reiterating perhaps what I just mentioned. One, I do think as we think about component cost increases, we'll adjust our pricing as appropriate. We are going to have to work our way through the component supply dynamic situation, and that's going to be an area that we're going to have to actively manage as we go through the year.

So as I suggested in the -- in my comments, I would tell you to take the Q1 revenue framework and move -- to bring that forward through your sequential models with some thought around the comments I just gave you around Q2 sequentials. And then look, from my perspective, I don't want to get into the back half. So we'll update you on our Q3 thinking on our Q2 call. And then we have a scheduled -- or we're anticipating scheduling an analyst meeting in September, where we'll give you more thoughts on the back half of the year and the go forward.

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**Operator**

Our next question is from Amit Daryanani with Evercore.

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

Tom, I was hoping we could just maybe talk a little bit more on the free cash flow side. It was a lot more positive in the April quarter versus at least what my model had, which is more neutral maybe. So maybe just talk about what drove that performance in the April quarter. And then I don't expect you to give me a full fiscal 2022 outlook, but what are the 2 or 3 puts and takes we should consider for the rest of the year from a free cash flow generation basis, especially given how strong April was?

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

Yes. Look, I'll answer half of that question, and I'll ask Tyler Johnson to jump in as well, our Treasurer. So the performance in cash for Q1 was quite strong. And you're right, our seasonal pattern is typically a use of cash in Q1 given some of the dynamics of the business from a seasonality perspective and bonus payouts and things of that sort. Given the strength in the business though, quarter-on-quarter, we did see strong cash flow generation in the quarter. And I think coupled with working capital management, the discipline that we've shown over the last number of years around working capital, we -- I was very pleased with the cash performance. Tyler, what would you add, comments, thoughts about the environment from a cash perspective?

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

I'd probably just add, we obviously benefit as we get this higher mix of CSG because that typically has shorter terms. So there's a benefit there. And look, our collections teams did just an outstanding job. So that was great.

Just as a reminder, too, and as you compare it to a year ago, we did have a COVID impact last year. I think that was somewhere around $900 million. But look, as Tom said, it was a great cash flow quarter. We don't guide forward on cash flow. But as I think about the rest of the year, at least as I think about next quarter, Q2 and Q4 tends to be our stronger cash flow quarters. And I am expecting Q2 to be a good cash flow quarter.

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**Operator**

Our next question is from Katy Huberty with Morgan Stanley.
Kathryn Lynn Huberty - Morgan Stanley, Research Division - MD and Research Analyst

Tom, last quarter, you said there wasn’t yet confidence in the pace and timing of ISG recovery, which influenced your view of profit declines for the year. Can you just update us on where your visibility and confidence in ISG revenue recovery is today versus 90 days ago? And if it recovers, as it's started to in the first quarter, does that give you a possible path to profit growth for the year if you execute through the supply dynamics you talked about?

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

Yes, Katy. I was pleased with the progress that we made in ISG in Q1, overall revenue of $7.9 billion, up 5%, operating income a little bit up against a year ago but headed in the right direction. We saw server velocity improving as the demand for compute accelerated, and servers and networking were up 9%. So pleased with that. IDC, as you would note, has a slightly positive sort of spin on server revenue growth for the year; saw improvement in storage with -- flat year-on-year, which is obvious from a revenue perspective but improvement from Q4; really pleased with the progress we're making in midrange. HCI continues to be strong. PowerStore receptivity is -- from a customer base perspective, has been good. And we're seeing net new buyers increasing in storage. So Q1 was positive.

As we look out to the rest of the year, again, while I don't want to forecast the rest of the year, we'll continue to see how the trends shape. We are reasonably optimistic that the IDC forecast for servers will -- and storage continues to -- will continue to be positive as it is in Q2, and we'll continue to see progress there. So I think as we get to the back half of the year and read it through Q2, we'll give you our perspective on the back half in terms of does ISG velocity continue. We do -- we -- at this point, we believe that it is a positive trend and that we expect it to improve as we go through the year, as we have said in the past; so overall, cautiously optimistic about the year for ISG.

Operator

Our next question is from Toni Sacconaghi with Bernstein.

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

I have a question about your reselling relationship with VMware today. So I think in your last fiscal year, you resold about $4 billion worth of VMware product. A small minority of that was along with Dell product. Most of it was just distributing VMware product to resellers. What is the financial arrangement when you resell VMware products? So on that $3.5 billion that's not affiliated with Dell product, do you receive a commission? And is there any sort of internal revenue transfer deduction? And then when Dell and VMware are separate, will Dell still be receiving commissions? Or what will be the financial arrangement and incentive for Dell to continue to act as VMware's largest distributor?

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

Toni, without getting into a lot of detail there, you -- as you would know, today, any -- VMware is consolidated. So those -- the revenue flowing through Dell is effectively eliminated as we consolidate VMware. I would harken the relationship on the $3.5 billion that you referenced to distributor arrangement, where it’s a distributor-margin-type framework. And that's the intent as we move forward. Obviously, post spin, we're not eliminating the VMware revenue and related margin. But as highlighted in the commercial agreement framework, as we chatted about in April, we do expect that through our sales incentives and our selling organizations that we're incentivized to sell VMware. We still think about VMware as part of the -- from a first investor relationship given our tightly coupled solution capabilities that we have. So we're going to continue to move forward with VMware and push that as appropriate, but it's effectively a distributor arrangement.

Operator

Our next question is from Steven Fox with Fox Advisors.
**Steven Bryant Fox** - Fox Advisors LLC - Founder & CEO

I was wondering if you could dig in a little bit more into the storage orders. I think you mentioned up 23%. How does that sort of play into your thinking for the rest of the year? Any other color on the mix or how it's trending with certain customers would be helpful.

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

Yes. Steven, it's -- what -- if we just think about storage, storage revenue for first quarter was $3.8 billion, flat year-over-year. What I highlighted though was as we look at some of the families within the storage framework, we were very pleased with midrange storage up 23%. We're pleased with our HCI performance. We saw slower growth but still growth in our unstructured and our Isilon PowerScale offerings. Power -- the high end, which is a smaller portion of the market, was soft for us. We've highlighted that in the past couple of quarters. But as you recall, if you think about where from a total TAM addressable market it is, the midrange storage is the biggest area of opportunity for us. And we're pleased with the dynamic and the velocity that we're seeing there. I highlighted the fact that storage net new buyers was up 12%. So pleased with that. Within PowerStore, 20% of the buyers are new storage buyers. And we've got about 25% more competitive displacements year-over-year with PowerStore.

So we're pleased with the customer receptivity. We just recently announced a software upgrade in terms of -- which is our fourth software release for the family in the last year. And that's -- it's -- again, it's a micro-services and container-based architecture. So it's -- these are nondisruptive upgrades, but the 25% faster performance for mixed workloads, so more automation. So we're -- I think the pace of innovation within the PowerStore framework is continuing to move forward.

So having said that, look, we're cautiously optimistic about storage. So we've got -- we went from a negative growth in Q4 in storage revenue on a year-over-year basis. We now have flat. We need to get it to growth. And obviously, the point here is that it's got to continue to grow on a more consistent basis. But the overall economic environment and the buying environment and the IT forecasting would suggest that the storage market should continue to be positive for the year, and we'll -- it's our intention to take advantage of it. So cautiously optimistic but there's more work to do. We have more work to do on coverage models. We have more work to do to accelerate consistent performance across the entire portfolio. So those are areas of focus for us.

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

Yes. And so look, the industry forecast are for kind of mid-4% growth for the year, for the overall storage industry. So we feel pretty good about that opportunity going forward, for sure. Thanks, Steve. I appreciate that question.

**Operator**

Our next question is from Shannon Cross with Cross Research.

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

Tom, can you talk a bit about how APEX will impact the P&L and maybe working capital or CapEx over time? I realize it's still early, but as you look at how the subscription revenue and that will flow through, can you just give us some of your high-level thoughts?

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

Shannon, yes, look, I mean we're very excited about APEX. And you are right, it is very early in the journey with APEX. We just announced the first set of offerings at Dell Tech World a few weeks ago. But having said that, customer interest has been quite strong, and we're encouraged by that.
But -- so -- but from a financial perspective, as it relates to the year, I mean it’s clearly -- it’s just not going to have a material impact on the year as we think about it this year just given the size of the company that we are.

What we're going to watch and monitor is number of new customers coming into APEX to make sure that that’s ramping as appropriate and within our plans. And then as it becomes more relevant to the financial situation, we'll begin to give you some framework to think about around that. But you are right, on a subscription and revenue -- with a subscription-based offering, clearly, revenue and cash flows are impacted as those -- as that business ramps. But I'm confident given our size, our scale, our ability and our strong balance sheet that we'll navigate through that as appropriate. But again, we'll give you more information on that as the ramp -- at the appropriate time as we see the ramp.

Operator

Our next question is from Sidney Ho with Deutsche Bank.

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

My question is on the CSG side, clearly very strong results in the first quarter. How are you thinking about the revenue growth for that business for the remainder of the year? And if you can comment on your expectations for commercial versus consumer separately, that would be great. And how do you discount the potential impact from component shortage, which seems to be impacting CSG more?

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

Yes. Look, we're very pleased with the CSG performance, if I can get those words out. It's a pretty robust demand environment, and we saw that -- we saw strong demand in Q4. We saw it again in Q1, very -- overall revenue up 20% to $13.3 billion; 42% growth in consumer revenue, up to $3.5 billion; and $9.8 billion of commercial revenue, up 14% for Q1. So as we think about the future, there is no indication at this point in time that the demand environment remains strong.

Now what we're carefully watching is as we get into Q2 and the remainder of the year is that, as you highlighted, there are component supply and component cost dynamics that we will have to manage and work our way through. I highlighted in my prepared remarks that component costs in Q2 are going to be inflationary. We will price that inflation -- that input cost to increase as appropriate, and we'll have to watch to make sure that the -- we'll watch to see of any impact on demand.

And that's really the framework we're going to have to work our way through as we go through the year. If you look at IDC forecast, they are forecasting a very robust demand environment for calendar '21. I think something appropriately like 355 million, 357 million units, 18% growth, if I recall properly. And so we're optimistic about the business, but I do think that the supply dynamic in terms of availability is going to be -- have to be something we're going to have to navigate. And that's going to be with us. Our best point of view is that supply constraint continues on into next year. And our supply chain team is working that daily to ensure that we are managing that to the extent possible.

But Sidney, we're very positive about CSG. [The security] is strong. The longer-term trends are also very strong in CSG, as we think about the TAM expansion, as Jeff highlighted in his comments, from $600 billion in calendar ‘19 to $750 billion in 2025. And that's all based upon what's happening with the PC in terms of the PC as an essential unit. The density of PCs within households is increasing. We've got -- we're seeing faster refresh cycles given the migration to notebooks from desktops. We -- and so there's just lots of positive indicators. And then the ecosystem around the PC itself in terms of software and support, the services element, we've got work we're doing on making the PC experience a much more seamless and holistic experience.

And so we're very optimistic about the opportunity over the next coming years in the PC space as we continue to think about how do we grow and modernize the core business and then how do we build out the ecosystem and take advantage through our direct selling and cross-sell motion around the PC unit itself. So -- but again, there's work to do in the short term as we work our way through some of the component supply dynamics.
**Operator**
Our next question is from Rod Hall with Goldman Sachs.

**Roderick B. Hall - Goldman Sachs Group, Inc., Research Division - MD**
I wanted to come back to this net debt-to-EBITDA target you mentioned, Tom, of 1.5x. If we look at this cash flow glide path and all the other pieces of cash coming to you guys in the deal and Boomi and so on, I mean that seems like a lot of cash that frees up for Dell Technologies shareholders to be distributed or maybe it’s M&A. But I wonder if you could just comment a little bit on the timing on that. And then also, what are your priorities? Is it -- do you have any thoughts on -- is it dividend? Is it buyback? How do you prioritize the return of that cash?

**Thomas W. Sweet - Dell Technologies Inc. - Executive VP & CFO**
Yes, Rod, you are right, if things play out as we presume they will, given the VMware spin and the business performance that we're seeing, we -- there is a substantial amount of cash coming to Dell Technologies. And we've highlighted that as -- vis-à-vis our adjusted upward target around debt repayment to $16 billion-plus of debt repayment. If those play out as we think about it and we're investment-grade post the anticipated VMware spin transaction, it does open up the opportunity to broaden out our capital allocation framework. And we've talked about this a bit, as you know. I think over the last 5 years, roughly about 90% to 95% of our free cash flow has been devoted to debt repayment. That pivots obviously given the situation or the opportunity we'll have later in the year.

So we are going to broaden our capital allocation strategy. Part of that will be a program around shareholder capital return. And that's a balance between -- as we think our way through dividend or share buyback or some combination thereof as well as investment in the business and potentially targeted inorganic M&A activity. I'd offer up that we will provide some more thoughts on this whole area as we get closer to the VMware spin transaction date and give you some frameworks to think about at that point in time.

**Tyler W. Johnson - Dell Technologies Inc. - Senior VP & Treasurer**
Rod, and just to make sure that I heard you correctly, because I thought you might have said net debt. I just want to be clear it's gross debt at 1.5x.

**Robert L. Williams - Dell Technologies Inc. - SVP of IR**
Perfect. Thanks for that clarification, Tyler.

**Operator**
Our next question will come from Matt Cabral with Credit Suisse.

**Matthew Normand Cabral - Crédit Suisse AG, Research Division - Research Analyst**
It sounded from the prepared remarks like you guys had a really strong quarter in China. I was wondering if you could just remind us how big China is within the portfolio and maybe speak to the areas of strength that you saw during the quarter there. And then just broadly, how we should think about sustainability within China going forward.
Thomas W. Sweet - Dell Technologies Inc. - Executive VP & CFO

Yes. Matt, so China is roughly, from a revenue basis, about 6%, 7% of consolidated revenue at this point. It’s our second largest business unit. Having said that, it’s -- from a percent of operating income generation, it’s much less than that, okay? It tends to be a lower ASP business. And the mix dynamic over there is a bit more skewed towards the client. The sustainability of it -- look, I mean we’ve come through a couple of tough years with China in terms of having to reset that business and refocus the business from customer base -- refocusing on specific segments of customer base, principally focused on the smaller corporates, medium business, building out the direct selling motion, building out the medium business frameworks over there. Sustainability continues to be an area that we’re thinking our way through.

There’s obviously geopolitical dynamics we -- that you have to work your way through. But the China market is a big market. We’re -- we’ve been in China a long time. We’re there to make sure that we can serve the China market appropriately. But we will continue to watch the cost structure over there and adjust appropriately given the business velocity that we’re seeing but reasonably optimistic in the long term, but it’s an area of continued focus as we -- to make sure that we set the business model over there appropriately.

Operator

Our next question is from Simon Leopold with Raymond James.


I wanted to see if maybe you could give us a little bit more help on what your thinking is happening currently in your gross margins. And what I’m getting at is really trying to understand what kind of pressure you’re experiencing from supply chain for Dell from things like expedite fee for components or increased prices. So just trying to get a better sense of how to quantify the gross margin headwind you would relate to your supply chain issues.

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

Yes, Simon, I'm not really going to parse that a lot for you. But I will tell you that, as I highlighted, that we are seeing component cost inflation in Q2 and remind you that Q1 was a component cost deflationary period for us. So we’re moving from deflation to inflation. We have seen increased logistics costs just given the availability of containers. The overall transport costs are up. We have air transports up. Shipping containers are at a premium. So those have all been headwinds into the logistics cost. Now this is what we do every day. So we’re managing our way through it. But to the extent that we’re seeing increased costs there, we are passing those through as appropriate. And there is no signs that these are going to subside anytime soon. I’ll say it like that just given the strong economic environment that we see from a demand perspective.

Operator

We’ll now take our final question from Aaron Rakers with Wells Fargo.

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

I wanted to kind of build on Simon’s question there. As we think about the ISG segment, a lot of the component costs or a lot of component constraints have been kind of centered, it seems like, on the PC segment. Have you seen constraints in your ability to meet demand in the ISG segment, particularly servers? And if so, how would you characterize kind of the lead times on products or for that matter, kind of backlog building if you are seeing constraints?
**Thomas W. Sweet** - Dell Technologies Inc. - Executive VP & CFO

Aaron, I would say it like this for ISG from a server perspective. We really haven’t seen significant supply constraint in the server space at this point. Obviously, some of the input costs are going up around DRAM and NAND. But in terms of our ability to meet demand, we’ve been able to navigate through that. And our lead times in servers are generally on standard lead times. So that environment – the ISG environment to date has been reasonably unaffected by some of the supply chain constraints as we look at it today.

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

Okay. Thanks. Hey, that’s going to wrap Q&A. I appreciate everyone joining us today. We’ll be participating virtually in a number of investor conferences and events throughout June and July. So please check the IR website, look for press releases from us for announcements of the upcoming events. Thanks for joining us today.

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**Operator**

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