Fitch Affirms Dell Technologies at 'BB+'; Revises Outlook to Negative

Fitch Ratings - New York - 15 November 2018: Fitch Ratings has affirmed the ratings for Dell Technologies, Inc. (Dell) and its subsidiaries, including the long-term Issuer Default Rating (IDR) at 'BB+'. Fitch has also assigned a 'BBB-' rating to Dell Inc.'s $5 billion incremental term loan. The Rating Outlook is revised to Negative from Stable. Fitch's actions affect $55.3 billion of total debt, including Dell's $4.0 billion and VMware's $1.0 billion undrawn revolving credit facilities (RCF). A full list of rating actions is provided below.

The ratings and Outlook follow Dell's enhanced offer to the company's Class V shareholders to exchange their Class V shares for Class C common shares in Dell or, at the option of the Class V shareholders, an aggregate cash consideration up to $14 billion, up $5 billion from the up to $9 billion original cash consideration. The $5 billion enhancement will be debt funded and should delay Dell's deleveraging to within Fitch's 3.5x core leverage negative sensitivity until the end of fiscal 2020 at the earliest. The Negative Outlook incorporates risks to weaker than expected operating performance or lower than anticipated debt reduction, given limited headroom at the current rating.

Fitch affirmed Dell's ratings on July 3, after the company announced the originally contemplated transaction in which VMware plans to pay an $11 billion special dividend to shareholders, $9 billion of which will be paid to Dell and fund Dell's then $9 billion aggregate cash consideration portion of the exchange offer. The deal simplifies Dell's VMware ownership structure and enhances contingent liquidity, as well as provides some clarity around Silver Laker Partners' exit strategy. However, the original exchange offer was leverage neutral , while the enhanced offer offsets the majority of Dell's $8.3 billion of gross debt reduction forecasted for the current fiscal year (before incremental debt to support the company's financing business). The exchange is subject to approval by shareholders at a special meeting currently scheduled for Dec. 11, 2018.

RATING ACTIONS

ENTITY	RATING			RECOVERY	PRIOR
Dell Inc.	LT IDR	BB+	Affirmed		BB+
senior unsecured	LT	BB	Affirmed	RR5	BB
Dell International LLC	LT IDR	BB+	Affirmed		BB+
senior secured	LT	BBB-	New Rating	RR1	
senior secured	LT	BBB-	Affirmed	RR1	BBB-
senior unsecured	LT	BB+	Affirmed	RR4	BB+
Dell Technologies Inc.	LT IDR	BB+	Affirmed		BB+
EMC Corp.	LT IDR	BB+	Affirmed		BB+
senior unsecured	LT	BB	Affirmed	RR5	BB
senior secured	LT	BBB-	Affirmed	RR1	BBB-
senior unsecured	LT	BB+	Affirmed	RR4	BB+
senior secured	LT	BBB-	New Rating	RR1	

KEY RATING DRIVERS

Debt Reduction Drive: Beyond this transaction, Fitch expects Dell will continue prioritizing gross debt reduction with FCF over the next two years, even after excluding VMware's FCF. Beyond the current fiscal year, Fitch expects Dell will repay $4.8 billion of gross debt in fiscal 2020 and $3.6 billion in fiscal 2021, partially offset by increasing Dell Financial Services (DFS) related debt. Dell may refinance a meaningful portion of its $9.9 billion of debt maturities in fiscal 2022 given Fitch estimated core leverage should be approaching 3x exiting fiscal 2021.

Strong VMware Performance: VMware should continue its strong operating performance, driven by robust adoption of the company's networking, hybrid cloud and software-as-a-service (SaaS) offerings. Fitch expects VMware will grow by mid- to high-single digits overall (double digits in hybrid and SaaS), leveraging the company's large and diversified installed base of virtualization and management customers. VMware's $1 billion of cross selling opportunities with Dell, given historically low penetration rates, should also boost organic revenue and Dell is guiding to $700 million of annualized revenue synergies in the current fiscal year.

Share Gains Boosting Revenue: Fitch expects ongoing share gains in personal computers (PC), higher PC peripherals and service attach rates and pricing discipline will drive continued momentum in Dell's Client Solutions Group (CSG), despite expectations for lower unit shipments. Dell, as well as the other top 2 PC makers, continue consolidating share from tier 2 and 3 players, a trend Fitch expects to continue as customers consolidate their supplier bases and given the impact design, procurement and supply chain scale.

Improving Infrastructure Performance: Infrastructure Services Group performance has resumed solid revenue growth, despite uneven buying patterns and increased white boxing by large cloud service providers (CSP) and execution issues in legacy storage during fiscal 2018. Dell's strong performance in industry standard servers, where the company and Hewlett Packard Enterprises (BBB+/Stable) share market leadership (40% share combined) and rapidly growing all flash arrays (AFA), hyper-converged and software-defined solutions should offset declining legacy storage technologies, which still constitute just under half of Dell's storage mix in the near term.

Strengthening Profitability: Dell's profitability should strengthen from higher revenue after contracting in fiscal 2017 and early fiscal 2018 from record high commodity prices. Fitch expects gradual profit margin expansion from achieving target cost synergies and moderating commodity prices, although DRAM may remain in tight supply through fiscal 2019. Fitch estimates operating EBITDA of roughly $10.1 billion for fiscal 2019 with margins up 100 basis points from the year ago period when operating EBITDA was $8.1 billion.

DERIVATION SUMMARY

Dell's core leverage is high for the peer group, although Dell's FCF based metrics are strong from the company's negative cash conversion cycle. Dell's continued focus on debt reduction with FCF in conjunction with operating EBITDA growth from positive revenue trends and cost synergy realization will strengthen credit metrics. The ratings also reflect Fitch expectations for positive organic revenue growth from share gains in PCs and servers, higher attach rates and solid growth at VMware. Fitch also believes moderate linkage between Dell and VMware provides meaningful contingent liquidity for Dell.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer
--Revenue reaches $91.3 billion in fiscal 2019 and grows low- to mid-single digits in fiscal 2020 from continued IT spending momentum and resumes slightly higher than GDP growth in fiscal 2021.
--Operating EBITDA margin expands from just 11% in fiscal 2019 to the mid-11% through the forecast period from operating leverage, margin expansion by VMware, ongoing achievement of cost synergies, including consolidation of EMC legacy product offerings.
--Capital spending remains near 2% of revenue.
--$2 billion of annual stock buybacks by VMware.
--DFS receivables and receivables sales grow in-line with consolidated revenue growth.
--Dell uses substantially all of FCF for debt reduction.

RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action
- Fitch believes greater than expected debt reduction from FCF, resulting in the expectation core leverage will be sustained below 3x and adjusted FCF (adjusted for the change in financing receivables) to debt below 5x in the near term.
- Positive revenue growth from profitable market share gains, despite challenging demand dynamics across its largest.

Developments that May, Individually or Collectively, Lead to Negative Rating Action
- Core leverage above 3.5x and FCF (adjusted for the change in financing receivables) to debt approaching the high single digits from weaker than expected profitability or lower than anticipated debt reduction.
- Pre-dividend FCF margin sustained below 2%, from lower than anticipated revenue.

LIQUIDITY AND DEBT STRUCTURE

Solid Liquidity: Fitch believes Dell's liquidity will remain solid and as of Aug. 3, 2018 consisted of i) $15.3 billion of cash, cash equivalents and short-term investments, a meaningful portion of which was attributable to VMware (before the $11.0 billion dividend) and ii) an undrawn $3.8 billion senior secured RCF expiring 2021. Fitch's expectation for $4 billion of annual FCF also supports liquidity, as does contingent liquidity at VMware and Dell's other strategically aligned businesses.

SUMMARY OF FINANCIAL STATEMENT ADJUSTMENTS

Fitch's material adjustments to the published financial statement of Dell Technologies, Inc. include its calculation of core leverage, which assumes a 3:1 debt-to-equity ratio on financing assets to calculate DFS debt. Fitch subtracts DFS debt from total debt to arrive at core debt and Fitch subtracts profitability related to DFS from total operating EBITDA to arrive at core EBITDA. Core leverage is core debt divided by core EBITDA.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Fitch derived the rating for VMware within the context of Fitch's parent-subsidiary linkage criteria and believes 'BB+' is appropriate, given the moderate linkage between the stronger subsidiary and weaker parent. Despite the absence of restrictions on restricted payments and inter-company loans more than offset the lack of upstream guarantees and cross-default provisions or the existence of governance structures on the Boards of Directors at both VMware and Dell Technologies.

Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018) (/site/re/10023785)
Sector Navigators (pub. 23 Mar 2018) (/site/re/10023790)
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018) (/site/re/10024585)
Parent and Subsidiary Rating Linkage (pub. 16 Jul 2018) (/site/re/10036366)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (/site/dodd-frank-disclosure/10051917)
Solicitation Status
Endorsement Policy (/site/regulatory)

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