



COMPANY UPDATE / ESTIMATE CHANGE TARGET CHANGE

Key Metrics

VMW - NYSE - as of	8/28/17	\$104.68
Price Target		\$122.00
52-Week Range	\$71.81 -	\$105.59
Diluted Shares Outstanding (000's)		409,654
Market Cap. (\$000's)		\$42,882,544
1-Mo. Average Daily Volume (000's)		1,569
Institutional Ownership (%)		23
Debt/Total Capital (net) % Q1'18		0
ROE %		15
Book Value / Share		\$19.75
Price / Book Value		5.3x
Indicated Dividend / Yield	\$0.00	0.0%
Current EBITDA Margin %		25.70

EPS FY 2/2

		Prior	Current		Prior	Current
	2016A	2018E	2018E*	A	2019E	2019E
1Q	\$0.86		\$0.99	A	\$1.11	\$1.11
2Q	\$0.97		\$1.19	A	\$1.32	\$1.29
3Q	\$1.14	\$1.33	\$1.29		\$1.46	\$1.40
4Q	\$1.43	\$1.61	\$1.62		\$1.76	\$1.77
Year	\$4.40	\$5.10	\$5.08		\$5.65	\$5.57
PE	23.8x		20.6x			18.8x

*Note fiscal year '17 changes to Dell FY '18

Revenue (\$mil)

		Prior	Current		Prior	Current
	2016A	2018E	2018E*	A	2019E	2019E
1Q	\$1,589		\$1,736	A	\$1,858	\$1,857
2Q	\$1,693		\$1,900	A	\$2,028	\$2,030
3Q	\$1,778	\$1,980	\$1,973		\$2,108	\$2,100
4Q	\$2,032	\$2,209	\$2,213		\$2,349	\$2,353
Year	\$7,092	\$7,824	\$7,822		\$8,342	\$8,341

Company Description: Palo Alto, CA based-VMware Inc. is the global leader in virtualization and cloud infrastructure solutions. VMware products include three key growth areas including, (SDDC) Software-Defined-Data-Center, (EUC) End-user Computing, & the Hybrid Cloud. License revenues constitute 36% of total revenue, while service revenue which includes software maintenance and professional services revenue represent 64% of total revenue.

Technology

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VMware Inc.

VMW - NYSE – Long-term Buy - 3

VMware Reports Solid Q2'18 Results & Improved FY Outlook

- Results.** VMware reported strong fiscal Q2 results on broad based product strength. Total Q2 revenue increased 12.2% y/y to \$1.900 billion. License revenue increased 13.7% y/y to \$732 million, well above flat growth reported in the year ago period. Service revenue of \$1.168 billion increased 11.3% y/y. Operating margin expanded 70 bps y/y. Q2 non GAAP EPS increased to \$1.19, the high end of management's guidance range, beating our prior \$1.17 view. Operating cash flow was \$620 million vs. \$577 million last year, while free cash flow was \$563 million, up 4% y/y. Deferred revenue totaled \$5.504 billion, up a better than expected 7% y/y. Total billings grew a strong 18% y/y. The company recently issued \$4 billion of senior notes, the proceeds of which will be used to repurchase an additional \$1 billion in VMW common shares which is in addition to the \$900 million remaining on the current buyback plan. The remaining proceeds will be used to pay off \$1.5 billion in notes due to parent company DELL/EMC and to increase liquidity. Total cash & investments were \$8.9 billion.
- Outlook.** With better than expected strength across products and regions, we now expect VMware to earn FY'18 EPS of \$5.08 on revenue of \$7.822 billion, well above our view from the start of the year. We also expect continued operating margin improvement from improved leverage and synergies related to the DELL/EMC acquisition. The general availability of VMware Cloud on AWS, greater adoption of NSX, vSAN, NFV, Cloud Foundation, Workspace ONE, Cross-Cloud Services, and vRealize cloud management tools, along with improved compute business guidance boosts our full year outlook vs. our view prior to the positive preliminary results reported in mid-August.
- Valuation & Opinion.** We slightly adjust our fiscal year end 2019 price target to \$122 from \$124. We maintain our Long-term Buy rating. The modest adjustment to our price target is the result of a slight decrease to our FY'19 EPS estimate to \$5.57 from \$5.65 multiplied by 22x, in line with our prior forward P/E multiple.

**Note Important Disclosures on Pages 5-6
Note Analyst Certification on Page 5**

VALUATION

We adjust our price target to \$122 from \$124 following the release of actual Q2 results and management's updated guidance and FY outlook. We note our \$122 price target is substantially above our prior \$107 price target prior to VMware's positive preliminary results announced in mid-August. Our price target offers investors a potential 16% return as of today's intraday price of \$104.93 through our investment timeframe of FYE'19 (2/2/2019). We calculate our price target by multiplying our FYE'19 EPS estimate of \$5.57 by 22x. We apply a 22x multiple, which is only slightly above the current 21x multiple, as we believe investors continue to underestimate VMware's new products and services, the improved growth profile of the traditional compute business, and continued synergies from the DELL acquisition of EMC, parent company of VMware. Based on updated and improved cash flow guidance from management and our discounted cash flow model, we believe investors continue to undervalue VMware's improved growth profile. We believe VMware's new partnerships with public cloud providers, along with continued strength from new products NSX, NFV, and vSAN, as well as cross-cloud services is boosting growth offsetting VMware's mature standalone vSphere business. As depicted in the chart below, a 22x multiple would align VMW's multiple with the overall IT sector which is growing substantially slower than VMware.

VMware Historical Consensus Forward P/E Multiple to Sector Average



Source: Thomson Reuters

SUITABILITY

We assign shares of VMW a suitability rating of 3 on our scale of 1-4 (1 = most conservative, 4 = most aggressive). A 3 rating is given based on high levels of competition within VMware's new end markets while the x86 server virtualization market is mature. We believe the company has a solid balance sheet and continues to generate significant free cash flow. VMware's unique ownership structure inside a larger Dell conglomerate has both positive and negative attributes. We believe a suitability rating of 3 incorporates VMware's risk profile. Shares of VMW are suitable for aggressive growth oriented investors seeking long-term capital appreciation, in our view.

RISKS & CONSIDERATIONS

Risks to our valuation include but are not limited to:

- Changes in macroeconomic conditions can affect global IT spending.
- Total revenue growth may slow as the compute virtualization market matures. A majority of workloads have been virtualized and, therefore, VMW now focuses on products and services for the platform-as-a-service and software-as-a-service markets. If these solutions are adopted more slowly or less broadly, VMware growth may slow.
- Retaining key personnel and the integration of newly acquired businesses.
- Breach of security could impact the company for a significant period of time.
- Foreign currency effects as well as fluctuations in sales cycle and the lack of predictability of future revenues.
- Reliance on third party channel partners, as a majority of sales were from these sources.
- Dell's controlling stake gives VMware stakeholders limited rights which may have negative impacts to long-term goals.
- VMW shares may experience high levels of price volatility due to a small outstanding float.

VMware Inc. Non GAAP Income Statement (in \$000's except per share data)

	2009	2010	2011	2012	2013	2014	2015	2016	Q1'18	Q2'18	Q3'18E	Q4'18E	2018E	2019E
Revenue:														
License	\$ 1,029,442	\$ 1,401,424	\$ 1,841,169	\$ 2,086,990	\$ 2,269,727	\$ 2,591,000	\$ 2,720,000	\$ 2,794,000	\$ 610,000	\$ 732,000	\$ 767,010	\$ 953,525	\$ 3,062,535	\$ 3,236,464
Services	994,495	\$ 1,455,919	\$ 1,925,927	2,518,057	2,936,839	3,444,000	3,928,000	4,298,000	1,126,000	1,168,000	1,206,570	1,259,500	4,760,070	5,104,955
Total Revenues	2,023,937	2,857,343	3,767,096	4,605,047	5,206,566	6,035,000	6,648,000	7,092,000	1,736,000	1,900,000	1,973,580	2,213,025	7,822,605	8,341,419
Operating expenses:														
Cost of license revenues	30,792	52,414	74,857	92,682	83,025	83,000	80,000	57,000	12,000	12,000	14,560	15,540	54,100	54,719
Cost of services revenues	217,720	292,318	384,865	450,644	489,016	679,000	784,000	839,000	233,000	221,000	233,200	244,200	931,400	989,726
Research and development	441,602	537,820	661,874	778,792	845,701	992,000	1,072,000	1,198,000	337,000	338,000	349,170	348,540	1,372,710	1,463,740
Sales and marketing	675,532	931,705	1,222,868	1,477,880	1,661,779	1,941,000	2,068,000	2,133,000	531,000	612,000	590,655	635,325	2,368,980	2,519,495
General and administrative	174,567	230,067	256,187	314,093	358,557	462,000	534,000	571,000	128,000	132,000	136,300	149,040	545,340	574,779
Operating income	483,724	813,019	1,166,445	1,490,956	1,768,488	1,878,000	2,110,000	2,294,000	495,000	585,000	649,695	820,380	2,550,075	2,738,961
Investment income	8,233	6,633	16,157	26,557	29,720	39,000	49,000	75,000	23,000	25,000	25,000	25,000	98,000	94,000
Interest expense, net	(6,958)	(4,069)	(3,906)	(4,654)	(3,865)	(26,000)	(27,000)	(28,000)	(7,000)	(7,000)	(10,000)	(12,000)	(36,000)	(14,000)
Other income, net	(2,980)	(14,182)	(9,009)	(732)	(1,874)	1,000	(5,000)	(2,000)	7,000	13,000	5,000	4,000	29,000	14,000
Income before income taxes	482,019	801,401	1,169,687	1,512,127	1,792,469	1,892,000	2,127,000	2,339,000	518,000	616,000	669,695	837,380	2,641,075	2,832,961
Income tax provision	80,989	162,494	233,936	276,538	331,322	349,000	398,000.00	478,000	106,190	126,850	140,636	175,850	549,526	580,757
Net income	\$ 401,030	\$ 638,907	\$ 935,751	\$ 1,235,589	\$ 1,461,147	\$ 1,543,000	\$ 1,729,000	\$ 1,861,000	\$ 411,810	\$ 489,150	\$ 529,059	\$ 661,530	\$ 2,091,549	\$ 2,252,204
Non GAAP basic EPS	\$ 1.02	\$ 1.56	\$ 2.22	\$ 2.90	\$ 3.40	\$ 3.59	\$ 4.08	\$ 4.43	\$ 1.01	\$ 1.20	\$ 1.30	\$ 1.63	\$ 5.13	\$ 5.62
Non GAAP diluted EPS	\$ 1.00	\$ 1.51	\$ 2.17	\$ 2.85	\$ 3.38	\$ 3.55	\$ 4.06	\$ 4.40	\$ 0.99	\$ 1.19	\$ 1.29	\$ 1.62	\$ 5.08	\$ 5.57
Basic shares outstanding	394,269	409,805	421,188	426,655	429,120	430,356	424,025	420,540	408,431	408,399	407,500	405,000	407,333	401,000
Diluted shares outstanding	399,776	423,446	431,750	433,588	432,813	434,063	426,033	423,201	414,018	412,768	411,000	408,000	411,447	404,625
Y/Y Growth Rate														
Total revenue	7.6%	41.2%	31.8%	22.2%	13.1%	15.9%	10.2%	6.7%	9.3%	12.2%	11.0%	8.9%	10.3%	6.6%
License revenue	-12.6%	36.1%	31.4%	13.4%	8.8%	14.2%	5.0%	2.7%	6.6%	13.7%	11.0%	7.5%	9.6%	5.7%
Service revenue	41.5%	46.4%	32.3%	30.7%	16.6%	17.3%	14.1%	9.4%	10.7%	11.3%	11.0%	10.0%	10.8%	7.2%
Cost of license revenue	27.8%	70.2%	42.8%	23.8%	-10.4%	0.0%	-3.6%	-28.8%	-20.0%	-20.0%	12.0%	11.0%	-5.1%	1.1%
Cost of service revenue	7.7%	34.3%	31.7%	17.1%	8.5%	38.9%	15.5%	7.0%	17.7%	6.8%	10.0%	10.0%	11.0%	6.3%
R&D	2.1%	21.8%	23.1%	17.7%	8.6%	17.3%	8.1%	11.8%	17.8%	17.0%	13.0%	11.0%	14.6%	6.6%
S&M	12.7%	37.9%	31.3%	20.9%	12.4%	16.8%	6.5%	3.1%	4.5%	16.1%	16.5%	7.5%	11.1%	6.4%
G&A	13.5%	31.8%	11.4%	22.6%	14.2%	28.8%	15.6%	6.9%	-5.9%	-9.6%	-6.0%	3.5%	-4.5%	5.4%
Operating income	3.2%	68.1%	43.5%	27.8%	18.6%	6.2%	12.4%	8.7%	11.0%	14.9%	9.7%	9.8%	11.2%	7.4%
Net income	-3.5%	59.3%	46.5%	32.0%	18.3%	5.6%	12.1%	7.6%	12.5%	18.2%	9.1%	10.8%	12.4%	7.7%
EPS	-4.1%	50.4%	43.6%	31.5%	18.5%	5.3%	14.2%	8.4%	15.3%	22.3%	12.8%	13.1%	15.6%	9.5%
Shares outstanding	0.7%	5.9%	2.0%	0.4%	-0.2%	0.3%	-1.8%	-0.7%	-2.4%	-3.4%	-3.3%	-2.0%	-2.8%	-1.7%
Percent of Revenue														
License revenue	50.9%	49.0%	48.9%	45.3%	43.6%	42.9%	40.9%	39.4%	35.1%	38.5%	38.9%	43.1%	39.1%	38.8%
Service revenue	49.1%	51.0%	51.1%	54.7%	56.4%	57.1%	59.1%	60.6%	64.9%	61.5%	61.1%	56.9%	60.9%	61.2%
Gross margin	87.7%	87.9%	87.8%	88.2%	89.0%	87.4%	87.0%	87.4%	85.9%	87.7%	87.4%	88.3%	87.4%	87.5%
R&D	21.8%	18.8%	17.6%	16.2%	16.9%	16.4%	16.1%	16.9%	19.4%	17.8%	17.7%	15.7%	17.5%	17.5%
S&M	33.4%	32.6%	32.5%	32.1%	31.9%	32.2%	31.1%	30.1%	30.6%	32.2%	29.9%	28.7%	30.3%	30.2%
G&A	8.6%	8.1%	6.8%	6.8%	6.9%	7.7%	8.0%	8.1%	7.4%	6.9%	6.9%	6.7%	7.0%	6.9%
Operating margin	23.9%	28.5%	31.0%	32.4%	34.0%	31.1%	31.7%	32.3%	28.5%	30.8%	32.9%	37.1%	32.6%	32.8%
Tax rate	16.8%	20.3%	20.0%	18.3%	18.5%	18.4%	18.7%	20.4%	20.5%	20.6%	21.0%	21.0%	20.8%	20.5%
Net profit margin	19.8%	22.4%	24.8%	26.8%	28.1%	25.6%	26.0%	26.2%	23.7%	25.7%	26.8%	29.9%	26.7%	27.0%

Source: Company data & Hilliard Lyons estimates. Note: FY'17 financials were skipped to align VMware with parent DELL/EMC FY'18 and y/y results will not be a direct comparison.

VMware Inc. Balance Sheet (in \$000's)

Assets	2008	2009	2010	2011	2012	2013	2014	2015	Q1'16	Q2'16	Q3'16	Q4'16	2016	Q1'18	Q2'18
Cash and cash equivalents	\$1,840,812	\$2,486,461	\$1,628,965	\$1,955,756	\$1,609,322	\$2,305,000	\$2,071,000	\$2,493,000	\$2,785,000	\$2,991,000	\$2,654,000	\$2,790,000	\$2,790,000	\$3,864,000	\$3,552,000
Short-term investments	-	27,360	1,694,675	2,556,450	3,021,512	3,870,000	5,004,000	5,016,000	5,461,000	5,674,000	5,600,000	5,195,000	5,195,000	4,748,000	5,350,000
Accounts receivable, net	338,014	534,196	614,726	882,857	1,150,906	1,220,000	1,520,000	1,633,000	1,089,000	1,215,000	1,119,000	1,856,000	1,856,000	867,000	1,189,000
Due from Dell, net	-	26,402	55,481	73,799	67,934	-	49,000	74,000	12,000	96,000	23,000	132,000	132,000	127,000	207,000
Deferred tax asset	44,573	63,360	100,689	128,471	179,430	190,000	248,000	-	-	-	-	-	-	-	-
Other current asset	166,689	44,701	203,119	80,439	90,935	96,000	238,000	144,000	147,000	167,000	159,000	362,000	362,000	172,000	173,000
Total current assets	2,390,088	3,182,480	4,297,655	5,677,772	6,120,039	7,681,000	9,130,000	9,360,000	9,494,000	10,143,000	9,555,000	10,335,000	10,335,000	9,778,000	10,471,000
Property and equipment, net	418,212	402,356	419,065	525,490	664,669	845,000	1,035,000	1,128,000	1,108,000	1,073,000	1,050,000	1,049,000	1,049,000	993,000	1,005,000
Capitalized software costs, net	134,553	169,293	151,945	154,236	128,701	107,000	174,000	193,000	195,000	218,000	232,000	248,000	248,000	240,000	262,000
Deferred tax asset	68,280	102,529	149,126	156,855	103,001	60,000	165,000	456,000	464,000	442,000	462,000	462,000	462,000	724,000	691,000
Intangible assets, net	56,984	94,557	210,928	407,375	731,852	607,000	748,000	616,000	582,000	577,000	538,000	517,000	517,000	474,000	476,000
Goodwill	771,088	1,115,769	1,568,600	1,759,080	2,848,130	3,027,000	3,964,000	3,993,000	3,993,000	4,031,000	4,032,000	4,032,000	4,032,000	4,032,000	4,270,000
Total assets	3,839,205	5,066,984	6,797,319	8,680,808	10,596,392	12,327,000	15,216,000	15,746,000	15,836,000	16,484,000	15,869,000	16,643,000	16,643,000	16,241,000	17,175,000
Liabilities and Stockholders' Equity															
Accounts payable	74,708	50,566	58,913	49,747	89,562	109,000	203,000	138,000	106,000	115,000	104,000	125,000	125,000	116,000	116,000
Accrued expenses and other	260,687	334,523	459,813	587,650	674,746	626,000	811,000	746,000	622,000	735,000	649,000	898,000	898,000	897,000	1,016,000
Due to related parties	-	-	-	-	-	-	-	-	-	-	-	-	-	680,000	680,000
Unearned revenues	544,355	908,953	1,270,426	1,764,109	2,195,926	2,558,000	2,982,000	3,245,000	3,181,000	3,276,000	3,279,000	3,531,000	3,531,000	3,317,000	3,464,000
Total current liabilities	879,750	1,294,042	1,789,152	2,401,506	2,960,234	3,293,000	3,996,000	4,129,000	3,909,000	4,126,000	4,032,000	4,554,000	4,554,000	5,010,000	5,276,000
Note payable to Dell	450,000	450,000	450,000	450,000	450,000	450,000	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000	820,000	820,000
Unearned revenues	325,634	416,345	589,668	944,309	1,264,639	1,534,000	1,851,000	1,831,000	1,795,000	1,846,000	1,815,000	2,093,000	2,093,000	1,918,000	2,040,000
Deferred tax liability	47,825	60,300	30,096	-	-	-	-	-	-	-	-	-	-	-	-
Other liabilities	65,929	103,346	129,960	114,711	181,538	234,000	283,000	363,000	361,000	376,000	388,000	399,000	399,000	425,000	440,000
Total liabilities	1,769,138	2,324,033	2,988,876	3,910,526	4,856,411	5,511,000	7,630,000	7,823,000	7,565,000	7,848,000	7,735,000	8,546,000	8,546,000	8,173,000	8,576,000
Stockholders' Equity															
Total stockholders' equity	2,070,067	2,742,951	3,808,443	4,770,282	5,739,981	6,816,000	7,586,000	7,923,000	8,271,000	8,636,000	8,134,000	8,097,000	8,097,000	8,068,000	8,599,000
Total liabilities and stockholders' equity	3,839,205	5,066,984	6,797,319	8,680,808	10,596,392	12,327,000	15,216,000	15,746,000	15,836,000	16,484,000	15,869,000	16,643,000	16,643,000	16,241,000	17,175,000

Source: Company data Note: FY'17 financials were skipped to align VMware with parent DELL/EMC FY'18 and y/y results will not be a direct comparison.

Other companies mentioned: Dell Technologies Inc. (DVMT-\$72.80).

Additional information is available upon request.

Analyst Certification

I, Stephen Turner, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

The author of this report or members of his household have a long position in the common stock of VMware Inc., but may not engage in buying or selling contrary to the recommendation.

Suitability Ratings

1 - A large cap, core holding with a solid history

2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage

4 - Speculative, due to small size, inconsistent profitability, erratic revenues, volatility, low trading volume or a narrow customer or product base

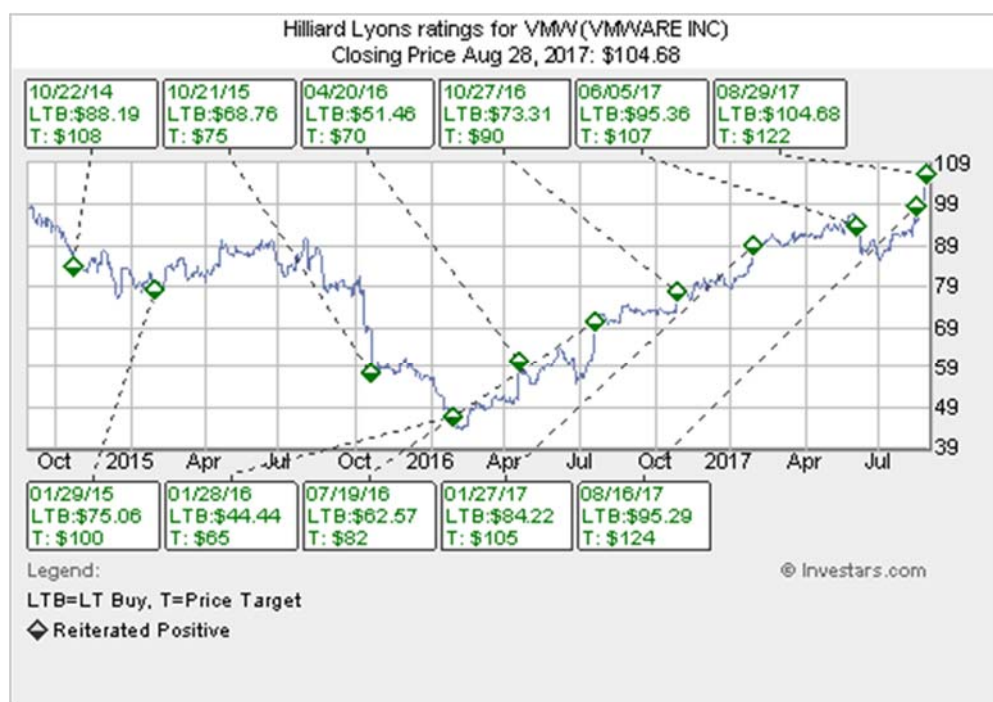
Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price setback in the next 12 months.



Hilliard Lyons Recommended Issues			Investment Banking Provided in Past 12 Mo.	
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	38	30%	11%	89%
Hold/Neutral	77	61%	8%	92%
Sell	11	9%	0%	100%

As of 9 August 2017

Other Disclosures

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