



COMPANY UPDATE / ESTIMATE CHANGE
TARGET CHANGE

Key Metrics

VMW - NYSE - as of	11/30/17	\$120.11
Price Target		\$145.00
52-Week Range	\$76.81 -	\$127.60
Diluted Shares Outstanding (000's)		408,947
Market Cap. (\$000's)		\$49,118,658
1-Mo. Average Daily Volume (000's)		1,958
Institutional Ownership (%)		23
Debt/Total Capital (net) % Q1'18		0
ROE %		15
Book Value / Share		\$21.06
Price / Book Value		5.7x
Indicated Dividend / Yield	\$0.00	0.0%
Current EBITDA Margin %		25.65

EPS FY 2/2

	2016A	Prior 2018E	Current 2018E*	Prior 2019E	Current 2019E
1Q	\$0.86		\$0.99 A	\$1.11	\$1.07
2Q	\$0.97		\$1.19 A	\$1.29	\$1.24
3Q	\$1.14		\$1.34 A	\$1.40	\$1.47
4Q	\$1.43	\$1.62	\$1.62	\$1.77	\$1.79
Year	\$4.40	\$5.08	\$5.14	\$5.57	\$5.57
P/E	27.3x		23.4x		21.6x

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

Revenue (\$mil)

	2016A	Prior 2018E	Current 2018E*	Prior 2019E	Current 2019E
1Q	\$1,589		\$1,736 A	\$1,857	\$1,929
2Q	\$1,693		\$1,900 A	\$2,030	\$2,084
3Q	\$1,778		\$1,976 A	\$2,100	\$2,171
4Q	\$2,032	\$2,213	\$2,264	\$2,353	\$2,473
Year	\$7,092	\$7,822	\$7,876	\$8,341	\$8,659

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 40% of total revenue, while service revenue which includes software maintenance and professional services revenue represent 60% of total revenue.

VMware Inc.

VMW - NYSE – Long-term Buy - 3

Improving Fundamental Results; Raising Price Target

- Results.** VMware reported non-GAAP EPS of \$1.34 vs \$1.14 reported in the year ago period, an increase of 17%. This beat our view of \$1.29 and the consensus analyst estimate of \$1.28. Non-GAAP revenue totaled \$1.976 billion, increasing 11% y/y. License revenues increased 14%, to \$785 million, above the \$772.9 million consensus estimate and our \$767 million view. License growth of 14% vs. 1.6% in the year ago quarter has been spurred by its partnership with Amazon's AWS. We expect growth to continue as the VMware Cloud expands its partnership with Amazon. Service revenue increased 9.6% y/y to \$1.191 billion. Operating income totaled \$689 million, up 16.4% y/y as operating margin expanded 160 bps y/y. Net income totaled \$553 million, an increase of 14% y/y. Billings growth of 21% to \$2.119 billion exceeded recent growth measures and our \$2 billion view. NSX license bookings reaccelerated to over 100% y/y, while vSAN license bookings increased 150% y/y. Seven deals were over \$10 million vs. six in the year ago quarter, including VMware's largest deal in its history with DXC Technology for \$100 million. During the quarter, VMware introduced new VMware cloud services AppDefense, Discovery, NSX Cloud, Wavefront, and Pivotal Container Service. VMware also announced the acquisition of VeloCloud Networks, a leader in cloud delivered SD-WAN technology.
- Outlook.** We increase our FY'18 EPS estimate to \$5.14 from \$5.08 largely on the better than expected Q3 results. Our FY'18 revenue increases to \$7.87 billion from \$7.82 billion. Our FY'19 revenue estimate increases substantially to \$8.66 billion from \$8.34 billion as the initial license growth outlook from management was better than we expected on new product/service introductions, traditional compute licensing, and the VeloCloud acquisition. We maintain our FY'19 EPS target of \$5.57 despite the higher revenue view as we expect margins to reflect the pending acquisition and continued elevated R&D spending. We inaugurate a FY'20 EPS estimate of \$6.05.
- Valuation & Opinion.** We extend our investment timeframe by 12 months to FY'20. Our price target increases to \$145 from \$122 as we take our longer term outlook into consideration. Our increased price target reflects a fundamental improvement in operating performance. We maintain our Long-term Buy rating.

Note Important Disclosures on Pages 6-7
Note Analyst Certification on Page 6

ADDITIONAL DISCUSSION

VMware has \$7.4 billion of net cash on its balance sheet or \$17.88 per share. Operating cash flow was \$970 million vs. \$620 million last year, while free cash flow was \$911 million vs. \$590 million. We expect the higher level of free cash flow growth to be sustainable as business model changes and new cloud partnerships boost growth and reduce capital expense commitments. The company repurchased \$855 million of common stock and has over \$1 billion remaining in the program.

VALUATION

We extend our investment timeframe by 12 months to FYE'20. Our price target increases to \$145 from \$122 as we take our longer term outlook into consideration. Our price target reflects an overall improvement in fundamental operating metrics. VMware has made several business model changes in recent quarters including its decision to partner with Amazon AWS and other leading public cloud providers allowing vSphere technology to be more easily consumed. This change is boosting growth of traditional compute licensing while new offerings such as NSX and vSAN continue to grow substantially. We also believe enterprise spending will remain elevated through, or even well beyond, our investment timeframe. We expect higher spending from telecoms and the coming 5G rollout to benefit VMware results well through 2020. Our \$145 price target reflects a higher P/E multiple we are willing to pay for VMW shares. While our FY'19 EPS estimate remains unchanged at \$5.57, we expect longer term growth levels to remain stronger for longer, with improved cash flow, and a product development pipeline. Our estimate reflects some margin pressure from the VeloCloud acquisition.

Our price target offers investors a potential 17.4% return as of today's intraday price of \$123.50 through our investment timeframe of FYE'20 (2/1/2020). We calculate our price target by multiplying our FYE'20 EPS estimate of \$6.05 by 24x. We apply a 24x multiple, which is in line with the current forward 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 flows 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.

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 and relatively small public share float. 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	Q3'18	Q4'18E	2018E	2019E	2020E
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	\$ 785,000	\$ 1,020,050	\$ 3,147,050	\$ 3,537,455	\$ 3,809,840
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	1,191,000	1,244,615	4,729,615	5,122,058	5,484,466
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	1,976,000	2,264,665	7,876,665	8,659,514	9,294,307
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	11,000	15,260	50,260	55,362	56,000
Cost of services revenues	217,720	292,318	384,865	450,644	489,016	679,000	784,000	839,000	233,000	221,000	225,000	241,314	920,314	993,939	1,056,182
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	352,000	359,530	1,386,530	1,559,734	1,678,506
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	550,000	650,100	2,343,100	2,562,476	2,751,735
General and administrative	174,567	230,067	256,187	314,093	358,557	462,000	534,000	571,000	128,000	132,000	149,000	152,280	561,280	638,126	684,893
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	689,000	846,181	2,615,181	2,849,876	3,066,991
Investment income	8,233	6,633	16,157	26,557	29,720	39,000	49,000	75,000	23,000	25,000	33,000	25,000	106,000	94,000	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)	(28,000)	(28,000)	(70,000)	(112,000)	(109,000)
Other income, net	(2,980)	(14,182)	(9,009)	(732)	(1,874)	1,000	(5,000)	(2,000)	7,000	13,000	2,000	(4,000)	18,000	14,000	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	696,000	839,181	2,669,181	2,845,876	3,065,991
Income tax provision	80,989	162,494	233,936	276,538	331,322	349,000	398,000	478,000	106,190	126,850	143,000	176,228	552,268	583,405	628,528
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	\$ 553,000	\$ 662,953	\$ 2,116,913	\$ 2,262,471	\$ 2,437,463
Non GAAP basic EPS	\$ 1.02	\$ 1.56	\$ 2.22	\$ 2.90	\$ 3.40	\$ 3.59	\$ 4.08	\$ 4.43	\$ 1.01	\$ 1.20	\$ 1.36	\$ 1.64	\$ 5.20	\$ 5.64	\$ 6.20
Non GAAP diluted EPS	\$ 1.00	\$ 1.51	\$ 2.17	\$ 2.85	\$ 3.38	\$ 3.55	\$ 4.06	\$ 4.40	\$ 0.99	\$ 1.19	\$ 1.34	\$ 1.62	\$ 5.14	\$ 5.57	\$ 6.05
Basic shares outstanding	394,269	409,805	421,188	426,655	429,120	430,356	424,025	420,540	408,431	408,399	406,733	405,000	407,141	401,000	393,000
Diluted shares outstanding	399,776	423,446	431,750	433,588	432,813	434,063	426,033	423,201	414,018	412,768	413,013	409,200	412,250	405,875	402,750
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%	11.1%	11.5%	11.1%	9.9%	7.3%
License revenue	-12.6%	36.1%	31.4%	13.4%	8.8%	14.2%	5.0%	2.7%	6.6%	13.7%	13.6%	15.0%	12.6%	12.4%	7.7%
Service revenue	41.5%	46.4%	32.3%	30.7%	16.6%	17.3%	14.1%	9.4%	10.7%	11.3%	9.6%	8.7%	10.0%	8.3%	7.1%
Cost of license revenue	27.8%	70.2%	42.8%	23.8%	-10.4%	0.0%	-3.6%	-28.8%	-20.0%	-20.0%	-15.4%	9.0%	-11.8%	10.2%	1.2%
Cost of service revenue	7.7%	34.3%	31.7%	17.1%	8.5%	38.9%	15.5%	7.0%	17.7%	6.8%	6.1%	8.7%	9.7%	8.0%	6.3%
R&D	2.1%	21.8%	23.1%	17.7%	8.6%	17.3%	8.1%	11.8%	17.8%	17.0%	13.9%	14.5%	15.7%	12.5%	7.6%
S&M	12.7%	37.9%	31.3%	20.9%	12.4%	16.8%	6.5%	3.1%	4.5%	16.1%	8.5%	10.0%	9.8%	9.4%	7.4%
G&A	13.5%	31.8%	11.4%	22.6%	14.2%	28.8%	15.6%	6.9%	-5.9%	-9.6%	2.8%	5.8%	-1.7%	13.7%	7.3%
Operating income	3.2%	68.1%	43.5%	27.8%	18.6%	6.2%	12.4%	8.7%	11.0%	14.9%	16.4%	13.3%	14.0%	9.0%	7.6%
Net income	-3.5%	59.3%	46.5%	32.0%	18.3%	5.6%	12.1%	7.6%	12.5%	18.2%	14.0%	11.0%	13.8%	6.9%	7.7%
EPS	-4.1%	50.4%	43.6%	31.5%	18.5%	5.3%	14.2%	8.4%	15.3%	22.3%	17.3%	13.0%	16.8%	8.6%	8.6%
Shares outstanding	0.7%	5.9%	2.0%	0.4%	-0.2%	0.3%	-1.8%	-0.7%	-2.4%	-3.4%	-2.8%	-1.8%	-2.6%	-1.5%	-0.8%
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%	39.7%	45.0%	40.0%	40.9%	41.0%
Service revenue	49.1%	51.0%	51.1%	54.7%	56.4%	57.1%	59.1%	60.6%	64.9%	61.5%	60.3%	55.0%	60.0%	59.1%	59.0%
Gross margin	87.7%	87.9%	87.8%	88.2%	89.0%	87.4%	87.0%	87.4%	85.9%	87.7%	88.1%	88.7%	87.7%	87.9%	88.0%
R&D	21.8%	18.8%	17.6%	16.9%	16.2%	16.4%	16.1%	16.9%	19.4%	17.8%	17.8%	15.9%	17.6%	18.0%	18.1%
S&M	33.4%	32.6%	32.5%	32.1%	31.9%	32.2%	31.1%	30.1%	30.6%	32.2%	27.8%	28.7%	29.7%	29.6%	29.6%
G&A	8.6%	8.1%	6.8%	6.8%	6.9%	7.7%	8.0%	8.1%	7.4%	6.9%	7.5%	6.7%	7.1%	7.4%	7.4%
Operating margin	23.9%	28.5%	31.0%	32.4%	34.0%	31.1%	31.7%	32.3%	28.5%	30.8%	34.9%	37.4%	33.2%	32.9%	33.0%
Tax rate	16.8%	20.3%	20.0%	18.3%	18.5%	18.4%	20.5%	20.4%	20.5%	20.6%	20.5%	21.0%	20.7%	20.5%	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%	28.0%	29.3%	26.9%	26.1%	26.2%

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	2016	Q1'18	Q2'18	Q3'18
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	\$ 2,790,000	\$ 3,864,000	\$ 3,552,000	\$ 6,012,000
Short-term investments	-	27,360	1,694,675	2,556,450	3,021,512	3,870,000	5,004,000	5,016,000	5,195,000	4,748,000	5,350,000	5,600,000
Accounts receivable, net	338,014	534,196	614,726	882,857	1,150,906	1,220,000	1,520,000	1,633,000	1,856,000	867,000	1,189,000	900,000
Due from Dell, net	-	26,402	55,481	73,799	67,934	-	49,000	74,000	132,000	127,000	207,000	254,000
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	362,000	172,000	173,000	160,000
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	10,335,000	9,778,000	10,471,000	12,926,000
Property and equipment, net	418,212	402,356	419,065	525,490	664,669	845,000	1,035,000	1,128,000	1,049,000	993,000	1,005,000	1,031,000
Capitalized software costs, net	134,553	169,293	151,945	154,236	128,701	107,000	174,000	193,000	248,000	240,000	262,000	282,000
Deferred tax asset	68,280	102,529	149,126	156,855	103,001	60,000	165,000	456,000	462,000	724,000	691,000	641,000
Intangible assets, net	56,984	94,557	210,928	407,375	731,852	607,000	748,000	616,000	517,000	474,000	476,000	443,000
Goodwill	771,088	1,115,769	1,568,600	1,759,080	2,848,130	3,027,000	3,964,000	3,993,000	4,032,000	4,032,000	4,270,000	4,271,000
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	16,643,000	16,241,000	17,175,000	19,594,000
Liabilities and Stockholders' Equity												
Accounts payable	74,708	50,566	58,913	49,747	89,562	109,000	203,000	138,000	125,000	116,000	116,000	99,000
Accrued expenses and other	260,687	334,523	459,813	587,650	674,746	626,000	811,000	746,000	898,000	897,000	1,016,000	926,000
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	3,531,000	3,317,000	3,464,000	3,500,000
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	4,554,000	5,010,000	5,276,000	4,525,000
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	820,000	820,000	270,000
Unearned revenues	325,634	416,345	589,668	944,309	1,264,639	1,534,000	1,851,000	1,831,000	2,093,000	1,918,000	2,040,000	2,147,000
Long term debt	-	-	-	-	-	-	-	-	-	-	-	3,962,000
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	399,000	425,000	440,000	416,000
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	8,546,000	8,173,000	8,576,000	11,320,000
Stockholders' Equity												
Common stock Class A and B, net	3,904	4,028	4,167	4,236	4,287	4,000	4,000	4,000	4,000	4,000	4,000	4,000
Additional paid-in capital	1,836,513	2,339,079	2,955,971	3,212,264	3,431,710	3,496,000	3,380,000	2,728,000	2,728,000	1,448,000	1,640,000	879,000
Accumulated other comprehensive income	-	4,563	19,635	1,176	5,676	4,000	(1,000)	(8,000)	(8,000)	11,000	16,000	9,000
Non controlling interests	-	-	-	-	-	-	5,000	4,000	4,000	-	-	-
Retained earnings	229,650	395,281	828,670	1,552,606	2,298,308	3,312,000	4,198,000	5,195,000	5,195,000	6,605,000	6,939,000	7,382,000
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	8,097,000	8,068,000	8,599,000	8,274,000
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	16,643,000	16,241,000	17,175,000	19,594,000

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: Amazon Inc. (AMZN-\$1176.75)
Dell Technologies Inc. (DVMT-\$78.24).

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

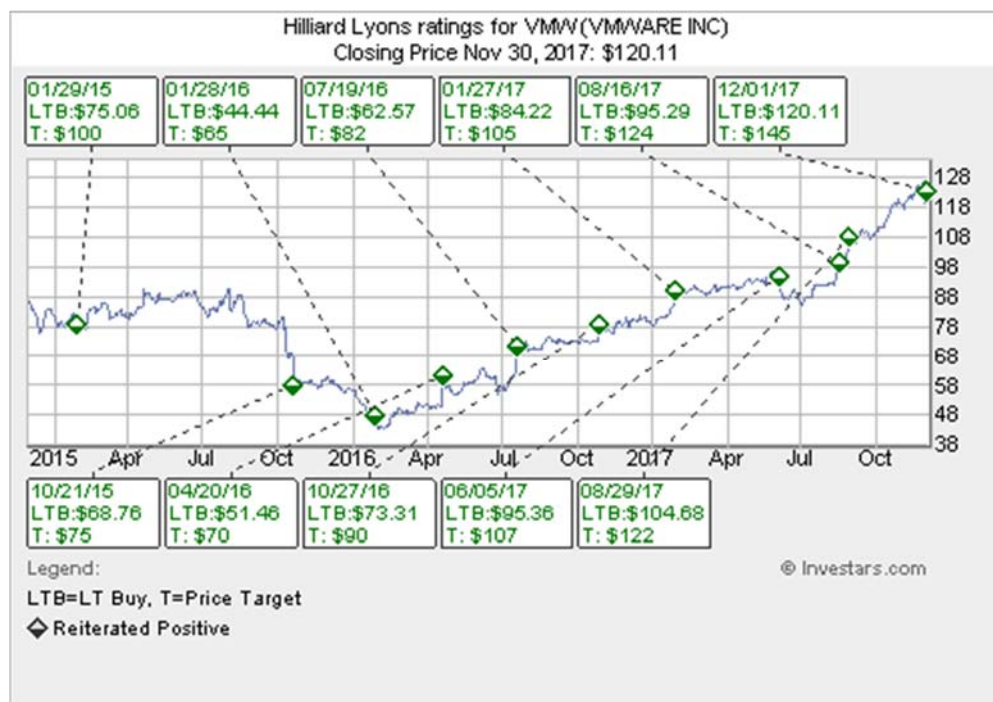
Investment Ratings

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.



Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	32	29%	13%	88%
Hold/Neutral	73	65%	7%	93%
Sell	7	6%	0%	100%

As of 8 November 2017

Other Disclosures

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