

Management's Discussion and Analysis of Financial Condition and Results of Operations

The Company's objective is to maximize stockholder value by executing a strategy that focuses on a balance of three priorities: growth, profitability and liquidity. The following discussion highlights the Company's performance in the context of these priorities. This discussion should be read in conjunction with the Consolidated Financial Statements.

RESULTS OF OPERATIONS

The following table summarizes the results of the Company's operations for each of the past three fiscal years. All percentage amounts were calculated using the underlying data in thousands.

| (dollars in millions) | | | Fiscal Year Ended | | January 28, 1996 |
|---|------------------|----------|-------------------|----------|------------------|
| | February 1, 1998 | Increase | February 2, 1997 | Increase | |
| Net revenue | \$ 12,327 | 59% | \$ 7,759 | 47% | \$ 5,296 |
| Gross margin | \$ 2,722 | 63% | \$ 1,666 | 56% | \$ 1,067 |
| Percentage of net revenue | 22.1% | | 21.5% | | 20.2% |
| Operating expenses | \$ 1,406 | 48% | \$ 952 | 38% | \$ 690 |
| Percentage of net revenue | 11.4% | | 12.3% | | 13.1% |
| Operating income | \$ 1,316 | 84% | \$ 714 | 90% | \$ 377 |
| Percentage of net revenue | 10.7% | | 9.2% | | 7.1% |
| Net income available to common stockholders | \$ 944 | 83% | \$ 518 | 99% | \$ 260 |

Net Revenue

The Company has become one of the top three computer vendors in the world as a result of its continued revenue growth. The increases in consolidated net revenue for both fiscal 1998 and fiscal 1997 were principally due to increased units sold. Unit shipments grew 60% and 55% for fiscal years 1998 and 1997, respectively.

The unit volume growth in fiscal 1998 resulted from increased demand for the Company's products across all product lines. This growth was driven by the Company's continued sales efforts to win new customer accounts through aggressive pricing actions and to increase market penetration of new and higher-end products, including products incorporating Intel's Pentium(R) Pro and Pentium II processors of speeds greater than 200MHz. While desktop products continue to be the primary driver of unit volumes (comprising 84% of total unit shipments in fiscal 1998), the growth rates in both the enterprise (the combination of servers and workstations) and notebook product lines exceeded the growth rate in desktops during fiscal 1998. Unit sales of desktop computers increased 55%, while unit sales of enterprise and notebook computers increased 265% and 66%, respectively, during fiscal 1998.

Average revenue per unit in fiscal 1998 remained relatively stable compared to fiscal 1997. Although aggressive pricing in the desktop product line adversely affected average revenue per unit, this was partially offset by increases in the enterprise and notebook product lines, primarily due to a migration to higher-end enterprise and higher-platform notebook systems.

The unit volume increase in fiscal 1997 was also a result of increased demand for the Company's products across all product lines. In particular, demand for enterprise products resulted in unit growth of 160% in fiscal 1997, compared to a 37% decrease in units in fiscal 1996. Additionally in fiscal 1997, the Company continued to introduce products utilizing latest technology, including products incorporating Intel's Pentium and Pentium Pro processors with speeds of 200MHz level.

The Company experienced growth in net revenue in all geographic regions in both fiscal 1998 and fiscal 1997. The following table summarizes the Company's net revenue by geographic region for each of the past three fiscal years:

| <i>(dollars in millions)</i> | <i>Fiscal Year Ended</i> | | | | | |
|------------------------------|--------------------------|------|-------------------------|------|-------------------------|------|
| | <i>February 1, 1998</i> | | <i>February 2, 1997</i> | | <i>January 28, 1996</i> | |
| Net revenue: | | | | | | |
| Americas | \$ 8,531 | 69% | \$ 5,279 | 68% | \$ 3,474 | 66% |
| Europe | 2,956 | 24 | 2,004 | 26 | 1,478 | 28 |
| Asia-Pacific and Japan | 840 | 7 | 476 | 6 | 344 | 6 |
| Consolidated net revenue | \$ 12,327 | 100% | \$ 7,759 | 100% | \$ 5,296 | 100% |

In the Americas region, where efforts have allowed the Company to build valuable supplier and customer relationships, net revenue grew 62% and 52% in fiscal 1998 and fiscal 1997, respectively. In the European region, substantially all countries experienced revenue growth in both fiscal 1998 and 1997. This allowed Europe to increase revenue 48% and 36% in fiscal 1998 and fiscal 1997, respectively. Asia-Pacific and Japan revenues increased 77% in fiscal 1998 compared to a 38% increase in fiscal 1997.

Management believes that opportunity exists for continued worldwide growth by increasing the Company's market presence in existing markets, entering new markets and pursuing additional product opportunities. In fiscal 1998, the Company continued to drive revenue growth through its Internet Web site located at www.dell.com. By fiscal year-end, revenue generated through this venue exceeded \$4 million a day. Management believes that the Internet will continue to be a significant sales and service medium for the Company in the future. Additionally in fiscal 1998, the Company expanded its product offerings to include high-performance workstations, and formed a business unit dedicated to workstations in order to grow this product line. As a result of these and other opportunities, the Company has announced plans to acquire an additional manufacturing facility in Limerick, Ireland and to construct an additional manufacturing facility in Austin, Texas and a manufacturing facility in Xiamen, China.

Gross Margin

The increase in gross margin as a percentage of net revenue in fiscal 1998 over fiscal 1997 was the result of several factors, including component cost declines (which were partially offset by price reductions), manufacturing efficiencies and an overall shift in mix to higher-end servers and higher-priced notebook platforms. Additionally in fiscal 1998, the Company experienced a higher mix of Intel's Pentium Pro and Pentium II processors with speeds greater than 200MHz. This contributed to the demand for higher-performance products, which typically carry higher gross margins. The Company's direct business model involves the maintenance of low levels of inventory. Consequently, component cost declines can have a significant impact on overall product costs and gross margin. During fiscal 1998, significant component cost declines occurred (particularly mid-year, in memory components), causing a decline in overall product costs. However, the Company's aggressive pricing strategies mitigated the impact of these cost declines on gross margin. Gross margin also benefited as the Company successfully migrated customers to higher-end enterprise systems with additional options for external storage capacity and higher-platform notebook computers. The mix of enterprise and notebook products increased to 9% and 20% of system revenue, respectively, compared with 4% and 18%, respectively, during the prior fiscal year.

The gross margin increase as a percentage of consolidated net revenue in fiscal 1997 resulted primarily from component cost declines (which were partially offset by price reductions) and a product mix shift to notebooks, servers and higher-end desktop products. Additionally, during fiscal 1996 the Company experienced a problematic product transition involving certain of its OptiPlex desktop products, which had an adverse effect on gross margin.

Management's Discussion and Analysis—continued

Operating Expenses

The following table presents certain information regarding the Company's operating expenses during each of the last three fiscal years:

| (dollars in millions) | Fiscal Year Ended | | |
|---------------------------------------|-------------------|------------------|------------------|
| | February 1, 1998 | February 2, 1997 | January 28, 1996 |
| Operating expenses: | | | |
| Selling, general and administrative | \$ 1,202 | \$ 826 | \$ 595 |
| Percentage of net revenue | 9.8% | 10.7% | 11.3% |
| Research, development and engineering | \$ 204 | \$ 126 | \$ 95 |
| Percentage of net revenue | 1.6% | 1.6% | 1.8% |
| Total operating expenses | \$ 1,406 | \$ 952 | \$ 690 |
| Percentage of net revenue | 11.4% | 12.3% | 13.1% |

Selling, general and administrative expenses increased in absolute dollar amounts but declined as a percentage of net revenue for both fiscal 1998 and 1997. The increase in absolute dollars was due primarily to the Company's increased staffing worldwide and increased infrastructure expenses, including information systems, to support the Company's continued growth. The decline in selling, general and administrative expense as a percentage of net revenue resulted from significant net revenue growth.

The Company continues to fund research, development and engineering activities to meet the demand for swift product cycles. As a result, research, development and engineering expenses have increased each year in absolute dollars due to increased staffing levels and product development costs. The Company expects to continue to increase research, development and engineering spending in absolute dollar amounts in order to invest in new products.

The Company believes that its ability to manage operating costs is an important factor in its ability to remain competitive and successful. The Company will continue to invest in information systems, personnel and other infrastructure, and in research, development and engineering activities, to support its growth and to provide for new, competitive products. Although operating expenses are expected to increase in absolute dollar terms, the Company's goal is to manage these expenses, over time, relative to its net revenue and gross margin.

Operating Income

While delivering annual revenue growth of 59% and 47% in fiscal years 1998 and 1997, respectively, the Company has grown operating income by 84% in fiscal 1998 and 90% in fiscal 1997. This reflects the Company's ability to manage operating expenses in relation to growth in gross margin to deliver strong operating performance.

Financing and Other

Financing and other increased \$19 million in fiscal 1998 from fiscal 1997 to \$52 million primarily as a result of increased investment income due to increased average marketable securities balances. Also, financing and other increased \$27 million in fiscal 1997 from fiscal 1996 to \$33 million due to increased investment income and decreased interest expense.

Income Taxes

The Company's effective tax rate was 31% for fiscal 1998 compared to 29% for both fiscal 1997 and 1996. The increase in the effective tax rate resulted from changes in the geographical distribution of income and losses. As a result of the Company's geographical distribution of income, the Company's effective tax rate is lower than the U.S. federal statutory rate of 35%.

LIQUIDITY AND CAPITAL RESOURCES

The following table presents selected financial statistics and information for each of the past three fiscal years:

| <i>(dollars in millions)</i> | <i>Fiscal Year Ended</i> | | |
|--------------------------------------|--------------------------|-------------------------|-------------------------|
| | <i>February 1, 1998</i> | <i>February 2, 1997</i> | <i>January 28, 1996</i> |
| Cash and marketable securities | \$ 1,844 | \$ 1,352 | \$ 646 |
| Working capital | \$ 1,215 | \$ 1,089 | \$ 1,018 |
| Days of sales in accounts receivable | 36 | 37 | 42 |
| Days of supply in inventory | 7 | 13 | 31 |
| Days in accounts payable | 51 | 54 | 33 |

During fiscal 1998, the Company generated \$1.6 billion in cash flows from operating activities, which represents the Company's principle source of cash. Cash flows from operating activities benefited from increased net income and continued asset management focus.

During fiscal 1998, the Company repurchased 69 million shares of its common stock for an aggregate cost of \$1.0 billion. The Company is currently authorized to repurchase up to 100 million additional shares of its common stock and anticipates that repurchases under this program will constitute a significant use of future cash resources. At February 1, 1998, the Company held equity instrument contracts that relate to the purchase of 50 million additional shares of its common stock for an average cost of \$44 per share exercisable at various times in the first quarter of fiscal 1999 through the third quarter of fiscal 2000. For additional information regarding the Company's stock repurchase program, see Note 7 of Notes to Consolidated Financial Statements.

The Company utilized \$187 million in cash during fiscal 1998 to construct and equip manufacturing and office facilities. The Company expects to spend approximately \$330 million to purchase capital items for manufacturing and office facilities during fiscal 1999 to support the Company's continued growth.

During fiscal 1998, the Company replaced two revolving credit facilities with one \$250 million 5-year revolving credit facility. Additionally, during fiscal 1996, the Company entered into a transaction that gives the Company the ability to raise up to \$150 million through a receivables securitization facility. At both February 1, 1998 and February 2, 1997, these facilities were unused.

During fiscal 1998, the Company entered into a \$227 million master lease facility, which allows the Company to lease certain real property, buildings and equipment to be constructed or acquired. At February 1, 1998, \$43 million of this facility had been utilized.

In March 1998, the Company filed a registration statement with the U.S. Securities and Exchange Commission related to \$500 million of debt securities. Presently, no securities under this registration are issued or outstanding.

Management believes that the Company has sufficient resources from cash provided from operations and available borrowings to support its operations and capital requirements for at least the next twelve months.

Management's Discussion and Analysis—continued

MARKET RISK

The Company is exposed to a variety of risks, including foreign currency fluctuations and changes in the market value of its investments. In the normal course of business, the Company employs established policies and procedures to manage its exposure to fluctuations in foreign currency values and changes in the market value of its investments.

Foreign Currency Hedging Activities

The Company's objective in managing its exposure to foreign currency exchange rate fluctuations is to reduce the impact of adverse fluctuations in earnings and cash flows associated with foreign currency exchange rate changes. Accordingly, the Company utilizes foreign currency option contracts and forward contracts to hedge its exposure on anticipated transactions and firm commitments. The principle currencies hedged are the British pound, Japanese yen, German mark, French franc and Canadian dollar. The Company monitors its foreign exchange exposures daily to ensure the overall effectiveness of its foreign currency hedge positions. However, there can be no assurance the Company's foreign currency hedging activities will substantially offset the impact of fluctuations in currency exchange rates on its results of operations and financial position.

Based on the Company's foreign exchange instruments outstanding at February 1, 1998, the Company estimates a maximum potential one-day loss in fair value of \$12 million, using a Value-at-Risk ("VAR") model. The VAR model estimates were made assuming normal market conditions and a 95% confidence level. There are various types of modeling techniques that can be used in a VAR computation; the Company used a Monte Carlo simulation type model that valued its foreign currency instruments against a thousand randomly generated market price paths. Anticipated transactions, firm commitments, receivables and accounts payable denominated in foreign currencies were excluded from the model. The VAR model is a risk estimation tool, and as such is not intended to represent actual losses in fair value that will be incurred by the Company. Additionally, as the Company utilizes foreign currency instruments for hedging anticipated and firmly committed transactions, a loss in fair value for those instruments is generally offset by increases in the value of the underlying exposure. Foreign currency fluctuations did not have a material impact on the Company during fiscal years 1998, 1997 and 1996.

Marketable Securities

The fair value of the Company's investments in marketable securities at February 1, 1998 was \$1.5 billion. The Company's investment policy is to manage its marketable securities portfolio to preserve principal and liquidity while maximizing the return on the investment portfolio through the full investment of available funds. The Company diversifies the marketable securities portfolio by investing in multiple types of investment-grade securities and through the use of different investment brokers. The Company's marketable securities portfolio is primarily invested in short-term securities with at least an investment grade rating to minimize interest rate and credit risk as well as to provide for an immediate source of funds. Based on the Company's marketable securities portfolio and interest rates at February 1, 1998, a 175 basis point increase or decrease in interest rates would result in a decrease or increase of \$17 million, respectively, in the fair value of the marketable securities portfolio. Although changes in interest rates may affect the fair value of the marketable securities portfolio and cause unrealized gains or losses, such gains or losses would not be realized unless the investments are sold.

FACTORS AFFECTING THE COMPANY'S BUSINESS AND PROSPECTS

There are numerous factors that may affect the Company's business and the results of its operations. These factors include general economic and business conditions; the level of demand for personal computers; the level and intensity of competition in the personal computer industry and the pricing pressures that may result; the ability of the Company to timely and effectively manage periodic product transitions and component availability; the ability of the Company to develop new products based on new or evolving technology and the market's acceptance of those products; the ability of the Company to manage its inventory levels to minimize excess inventory, declining inventory values and obsolescence; the product, customer and geographic sales mix of any particular period; the Company's ability to continue to improve its infrastructure (including personnel and systems) to keep pace with the growth in its overall business activities; and the Company's ability to ensure its products and information systems and those of its third party providers will be Year 2000 compliant. For a discussion of these and other factors affecting the Company's business and prospects, see "Item 1—Business— Factors Affecting the Company's Business and Prospects" in the Company's Annual Report on Form 10-K.

Consolidated Statement of Financial Position

ASSETS

| <i>(in millions)</i> | <i>February 1, 1998</i> | <i>February 2, 1997</i> |
|---|-------------------------|-------------------------|
| Current assets: | | |
| Cash | \$ 320 | \$ 115 |
| Marketable securities | 1,524 | 1,237 |
| Accounts receivable, net | 1,486 | 903 |
| Inventories | 233 | 251 |
| Other | 349 | 241 |
| Total current assets | 3,912 | 2,747 |
| Property, plant and equipment, net | 342 | 235 |
| Other | 14 | 11 |
| Total assets | \$ 4,268 | \$ 2,993 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,643 | \$ 1,040 |
| Accrued and other | 1,054 | 618 |
| Total current liabilities | 2,697 | 1,658 |
| Long-term debt | 17 | 18 |
| Deferred revenue on warranty contracts | 225 | 219 |
| Other | 36 | 13 |
| Commitments and contingent liabilities | — | — |
| Total liabilities | 2,975 | 1,908 |
| Put options | — | 279 |
| Stockholders' equity: | | |
| Preferred stock and capital in excess of \$.01 par value; shares issued and outstanding: none | — | — |
| Common stock and capital in excess of \$.01 par value; shares issued and outstanding: 644 and 692, respectively | 747 | 195 |
| Retained earnings | 607 | 647 |
| Other | (61) | (36) |
| Total stockholders' equity | 1,293 | 806 |
| | \$ 4,268 | \$ 2,993 |

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Income

| (in millions) | Fiscal Year Ended | | |
|---|-------------------|------------------|------------------|
| | February 1, 1998 | February 2, 1997 | January 28, 1996 |
| Net revenue | \$ 12,327 | \$ 7,759 | \$ 5,296 |
| Cost of revenue | 9,605 | 6,093 | 4,229 |
| Gross margin | 2,722 | 1,666 | 1,067 |
| Operating expenses: | | | |
| Selling, general and administrative | 1,202 | 826 | 595 |
| Research, development and engineering | 204 | 126 | 95 |
| Total operating expenses | 1,406 | 952 | 690 |
| Operating income | 1,316 | 714 | 377 |
| Financing and other | 52 | 33 | 6 |
| Income before income taxes and extraordinary loss | 1,368 | 747 | 383 |
| Provision for income taxes | 424 | 216 | 111 |
| Income before extraordinary loss | 944 | 531 | 272 |
| Extraordinary loss, net of taxes | — | (13) | — |
| Net income | 944 | 518 | 272 |
| Preferred stock dividends | — | — | (12) |
| Net income available to common stockholders | \$ 944 | \$ 518 | \$ 260 |
| Basic earnings per common share (in whole dollars): | | | |
| Income before extraordinary loss | \$ 1.44 | \$ 0.75 | \$ 0.36 |
| Extraordinary loss, net of taxes | — | (.02) | — |
| Earnings per common share | \$ 1.44 | \$ 0.73 | \$ 0.36 |
| Diluted earnings per common share (in whole dollars): | | | |
| Income before extraordinary loss | \$ 1.28 | \$ 0.68 | \$ 0.33 |
| Extraordinary loss, net of taxes | — | (.02) | — |
| Earnings per common share | \$ 1.28 | \$ 0.66 | \$ 0.33 |
| Weighted average shares outstanding: | | | |
| Basic | 658 | 710 | 716 |
| Diluted | 738 | 782 | 790 |

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows

| <i>(in millions)</i> | <i>Fiscal Year Ended</i> | | |
|---|--------------------------|-------------------------|-------------------------|
| | <i>February 1, 1998</i> | <i>February 2, 1997</i> | <i>January 28, 1996</i> |
| Cash flows from operating activities: | | | |
| Net income | \$ 944 | \$ 518 | \$ 272 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 67 | 47 | 38 |
| Other | 24 | 29 | 22 |
| Changes in: | | | |
| Operating working capital | 529 | 659 | (195) |
| Non-current assets and liabilities | 28 | 109 | 38 |
| Net cash provided by operating activities | 1,592 | 1,362 | 175 |
| Cash flows from investing activities: | | | |
| Marketable securities: | | | |
| Purchases | (12,305) | (9,538) | (4,545) |
| Maturities and sales | 12,017 | 8,891 | 4,442 |
| Capital expenditures | (187) | (114) | (101) |
| Net cash used in investing activities | (475) | (761) | (204) |
| Cash flows from financing activities: | | | |
| Purchase of common stock | (1,023) | (495) | — |
| Repurchase of 11% Senior Notes | — | (95) | — |
| Issuance of common stock under employee plans | 88 | 57 | 48 |
| Cash received from sale of equity options | 38 | — | — |
| Preferred stock dividends and other | (1) | — | (14) |
| Net cash (used in) provided by financing activities | (898) | (533) | 34 |
| Effect of exchange rate changes on cash | (14) | (8) | 7 |
| Net increase in cash | 205 | 60 | 12 |
| Cash at beginning of period | 115 | 55 | 43 |
| Cash at end of period | \$ 320 | \$ 115 | \$ 55 |

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Stockholders' Equity

| (in millions) | Preferred Stock and Capital in Excess of Par Value | | Common Stock and Capital in Excess of Par Value | | Retained Earnings | Other | Total |
|--|---|--------|---|--------|----------------------|---------|----------|
| | Shares | Amount | Shares | Amount | | | |
| Balances at January 29, 1995 | 1 | \$ 120 | 635 | \$ 242 | \$ 311 | \$ (21) | \$ 652 |
| Net income | — | — | — | — | 272 | — | 272 |
| Stock issuance under employee plans, including tax benefits | — | — | 33 | 74 | — | (17) | 57 |
| Preferred stock conversion | (1) | (114) | 80 | 114 | — | — | — |
| Other | — | — | — | — | (13) | 5 | (8) |
| Balances at January 28, 1996 | — | 6 | 748 | 430 | 570 | (33) | 973 |
| Net income | — | — | — | — | 518 | — | 518 |
| Stock issuance under employee plans, including tax benefits | — | — | 6 | 65 | — | (18) | 47 |
| Purchase and retirement of 62 million shares | — | — | (62) | (22) | (388) | — | (410) |
| Purchase and reissuance of 19 million shares for employee plans and preferred stock conversion | — | (6) | — | — | (55) | — | (61) |
| Reclassification of put options | — | — | — | (279) | — | — | (279) |
| Other | — | — | — | 1 | 2 | 15 | 18 |
| Balances at February 2, 1997 | — | — | 692 | 195 | 647 | (36) | 806 |
| Net income | — | — | — | — | 944 | — | 944 |
| Stock issuance under employee plans, including tax benefits | — | — | 21 | 274 | — | (11) | 263 |
| Purchase and retirement of 69 million shares | — | — | (69) | (39) | (984) | — | (1,023) |
| Reclassification of put options | — | — | — | 279 | — | — | 279 |
| Other | — | — | — | 38 | — | (14) | 24 |
| Balances at February 1, 1998 | — | \$ — | 644 | \$ 747 | \$ 607 | \$ (61) | \$ 1,293 |

The accompanying notes are an integral part of these consolidated financial statements.

NOTE 1—Description of Business and Summary of Significant Accounting Policies

Description of Business—Dell Computer Corporation, a Delaware corporation (including its consolidated subsidiaries, the “Company”) designs, develops, manufactures, markets, services and supports a wide range of computer systems, including desktops, notebooks and enterprise systems (includes servers and workstations), and also markets software, peripherals and service and support programs. The Company markets its computer products and services under the Dell(R) brand name directly to its customers. These customers include major corporate, government, medical and education accounts, as well as small-to-medium businesses and individuals. The Company conducts operations worldwide through wholly owned subsidiaries; such operations are primarily concentrated in the United States, Europe and the Asia-Pacific rim.

Fiscal Year—The Company’s fiscal year is the 52 or 53 week period ending on the Sunday nearest January 31.

Principles of Consolidation—The consolidated financial statements have been prepared in accordance with generally accepted accounting principles and include the accounts of the Company. All significant intercompany transactions and balances have been eliminated. Certain reclassifications have been made in the prior years for consistent presentation.

Use of Estimates—The preparation of financial statements in accordance with generally accepted accounting principles requires the use of management’s estimates. These estimates are subjective in nature and involve judgements that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at fiscal year end and the reported amounts of revenues and expenses during the fiscal year. Actual results could differ from those estimates.

Marketable Securities—The Company’s marketable securities are classified as available-for-sale and are reported at fair value. Unrealized gains and losses are reported, net of taxes, as a component of stockholders’ equity. Unrealized losses are charged against income when a decline in fair value is determined to be other than temporary. The specific identification method is used to determine the cost of securities sold. Gains and losses on marketable securities are included in financing and other when realized. The Company accounts for highly liquid investments with maturities of three months or less at date of acquisition as marketable securities and reflects the related cash flows as investing cash flows. As a result, a significant portion of its gross marketable securities purchases and maturities disclosed as investing cash flows is related to highly liquid investments.

Inventories—Inventories are stated at the lower of cost or market. Cost is determined on a first-in, first-out basis.

Property, Plant and Equipment—Property, plant and equipment are carried at depreciated cost. Depreciation is provided using the straight-line method over the estimated economic lives of the assets, which range from ten to thirty years for buildings and two to five years for all other assets. Leasehold improvements are amortized over the shorter of five years or the lease term.

Foreign Currency Translation—The majority of the Company’s international sales are made by international subsidiaries which have the U.S. dollar as their functional currency. International subsidiaries which have the U.S. dollar as the functional currency are remeasured into U.S. dollars using current rates of exchange for monetary assets and liabilities and historical rates of exchange for nonmonetary assets. Gains and losses from remeasurement are included in financing and other. The Company’s subsidiaries that do not have the U.S. dollar as their functional currency translate assets and liabilities at current rates of exchange in effect at the balance sheet date. The resulting gains and losses from translation are included as a component of stockholders’ equity. Items of income and expense for the Company’s international subsidiaries are translated using the monthly average exchange rates in effect for the period in which the items occur.

Foreign Currency Hedging Instruments—The Company enters into foreign exchange contracts to hedge its foreign currency risks. These contracts must be designated at inception as a hedge and measured for effectiveness both at inception and on an ongoing basis. Realized and unrealized gains or losses and premiums on foreign currency purchased option contracts that are designated and effective as hedges of probable anticipated, but not firmly committed, foreign currency transactions are deferred and recognized in income as a component of revenue, cost of sales and/or operating expenses in the same period as the hedged transaction. Forward contracts designated as hedges of probable anticipated or firmly committed transactions are accounted for on a mark-to-market basis, with realized and unrealized gains or losses recognized currently.

Notes to Consolidated Financial Statements—continued

Equity Instruments Indexed to the Company's Common Stock—Proceeds received upon the sale of equity instruments and amounts paid upon the purchase of equity instruments are recorded as a component of stockholders' equity. Subsequent changes in the fair value of the equity instrument contracts are not recognized. If the contracts are ultimately settled in cash, the amount of cash paid or received is recorded as a component of stockholders' equity.

Revenue Recognition—Sales revenue is recognized at the date of shipment to customers. Provision is made for an estimate of product returns and doubtful accounts and is based on historical experience. Revenue from separately priced service and extended warranty programs are deferred and recognized over the extended warranty period.

Warranty and Other Post-sales Support Programs—The Company provides currently for the estimated costs that may be incurred under its initial warranty and other post-sales support programs.

Advertising Costs—Advertising costs are charged to expense as incurred. Advertising expenses for fiscal years 1998, 1997 and 1996 were \$137 million, \$87 million and \$83 million, respectively.

Stock-Based Compensation—The Company adopted Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," in the fiscal year ended February 2, 1997. On adoption, the Company continued to apply Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for its stock option and stock purchase plans. As a result, no expense has been recognized for options granted with an exercise price equal to market value at the date of grant or in connection with the employee stock purchase plan. For stock options that have been issued at discounted prices, the Company accrues for compensation expense over the vesting period for the difference between the exercise price and fair market value on the measurement date.

Income Taxes—The provision for income taxes is based on income before income taxes as reported in the Consolidated Statement of Income. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

Earnings Per Common Share—The Company adopted Statement of Financial Accounting Standards No. 128, "Earnings Per Share," in the fiscal year ended February 1, 1998. Basic earnings per share is based on the weighted effect of all common shares issued and outstanding, and is calculated by dividing net income available to common stockholders by the weighted average shares outstanding during the period. Diluted earnings per share is calculated by dividing net income available to common stockholders by the weighted average number of common shares used in the basic earnings per share calculation plus the number of common shares that would be issued assuming conversion of all potentially dilutive common shares outstanding. All historical earnings per share data have been restated to conform to this presentation. Below is the calculation of basic and diluted earnings per share for each of the past three fiscal years:

| (in millions, except per share data) | Fiscal Year Ended | | |
|---|-------------------|------------------|------------------|
| | February 1, 1998 | February 2, 1997 | January 28, 1996 |
| Net income | \$ 944 | \$ 518 | \$ 272 |
| Less: preferred stock dividends | — | — | (12) |
| Net income available to common stockholders | \$ 944 | \$ 518 | \$ 260 |
| Weighted average shares outstanding — Basic | 658 | 710 | 716 |
| Employee stock options and other | 80 | 72 | 74 |
| Weighted average shares outstanding — Diluted | 738 | 782 | 790 |
| Earnings per common share: | | | |
| Basic | \$ 1.44 | \$ 0.73 | \$ 0.36 |
| Diluted | \$ 1.28 | \$ 0.66 | \$ 0.33 |

Recently Issued Accounting Pronouncement—On March 4, 1998, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants, issued Statement of Position 98-1 (SoP 98-1), "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," which provides guidance concerning the capitalization of costs related to such software. The SoP 98-1 must be adopted by the Company effective as of fiscal year 2000 and is not expected to have a material impact to the Company's consolidated results of operations or financial position.

NOTE 2—Financial Instruments Disclosures About Fair Values of Financial Instruments

The fair value of marketable securities, long-term debt and interest rate derivative instruments has been estimated based upon market quotes from brokers. The fair value of foreign currency forward contracts has been estimated using market quoted rates of foreign currencies at the applicable balance sheet date. The estimated fair value of foreign currency purchased option contracts is based on market quoted rates at the applicable balance sheet date and the Black-Scholes options pricing model. Considerable judgment is necessary in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange. Changes in assumptions could significantly affect the estimates.

Cash, accounts receivable, accounts payable and accrued and other liabilities are reflected in the financial statements at fair value because of the short-term maturity of these instruments.

MARKETABLE SECURITIES

The following table summarizes by major security type the fair value of the Company's holdings of marketable securities.

| <i>(in millions)</i> | <i>February 1, 1998</i> | <i>February 2, 1997</i> |
|---|-------------------------|-------------------------|
| Preferred stock | \$ 172 | \$ 172 |
| Mutual funds, principally invested in debt securities | 800 | 182 |
| Debt securities: | | |
| State and municipal securities | 190 | 317 |
| U.S. corporate and bank debt | 307 | 415 |
| U.S. government and agencies | 40 | 98 |
| International corporate and bank debt | 15 | 53 |
| Total debt securities | 552 | 883 |
| Total marketable securities | \$ 1,524 | \$ 1,237 |

At February 1, 1998 and February 2, 1997, the cost of marketable securities approximates fair value. At February 1, 1998, debt securities with a carrying amount of \$414 million mature within one year; the remaining debt securities mature within three years. The Company's gross realized gains and losses on the sale of marketable securities for fiscal years 1998, 1997 and 1996 were not material.

FOREIGN CURRENCY INSTRUMENTS

The Company uses foreign currency purchased option contracts and forward contracts to reduce its exposure to currency fluctuations involving probable anticipated, but not firmly committed, transactions and transactions with firm foreign currency commitments. These transactions include international sales by U.S. dollar functional currency entities, foreign currency denominated purchases of certain components and intercompany shipments to certain international subsidiaries. The risk of loss associated with purchased options is limited to premium amounts paid for the option contracts. Foreign currency purchased options generally expire in twelve months or less. At February 1, 1998, the Company held purchased option contracts with a notional amount of \$2.0 billion, a carrying amount of \$69 million and a combined net realized and unrealized deferred loss of \$2 million. Additionally, at February 2, 1997, the Company held purchased option contracts with a notional amount of \$1.2 billion, a carrying amount of \$33 million

Notes to Consolidated Financial Statements—continued

and a combined net realized and unrealized deferred gain of \$25 million. The risk of loss associated with forward contracts is equal to the exchange rate differential from the time the contract is entered into until the time it is settled. Transactions with firm foreign currency commitments are generally hedged using foreign currency forward contracts for periods not exceeding three months. At February 1, 1998, the Company held forward contracts with a notional amount of \$800 million, a carrying amount of \$26 million and a combined net realized and unrealized deferred gain of \$10 million. At February 2, 1997, the Company held foreign currency forward contracts with a notional amount of \$207 million and a contract carrying amount of \$12 million, which represented fair value.

LONG-TERM DEBT AND INTEREST RATE RISK MANAGEMENT

During fiscal 1997, the Company repurchased \$95 million of its outstanding \$100 million 11% Senior Notes Due August 15, 2000 (the "Senior Notes"). As a result of the repurchase, the Company recorded an extraordinary loss of \$13 million (net of tax benefit of \$7 million). In connection with the Senior Notes, the Company entered into interest rate swap agreements that expire on August 15, 1998. At February 1, 1998 and February 2, 1997, the Company had outstanding receive fixed/pay floating interest rate swap agreements in the aggregate notional amount of \$100 million offset by receive floating/pay fixed interest rate swap agreements in the aggregate notional amount of \$100 million. The notional amount of both the receive fixed/pay floating interest rate swaps and the offsetting receive floating/pay fixed interest rate swaps was marked-to-market and included in the extraordinary loss. The weighted average interest rate on the Senior Notes, adjusted by the swaps, was 13.8% for fiscal years 1998, 1997 and 1996, respectively. The difference between the Company's carrying amounts and fair value on long-term debt and related interest rate swaps was not material at both February 1, 1998, and February 2, 1997, respectively.

NOTE 3—Income Taxes

The provision for income taxes consists of the following:

| (in millions) | Fiscal Year Ended | | |
|----------------------------|-------------------|------------------|------------------|
| | February 1, 1998 | February 2, 1997 | January 28, 1996 |
| Current: | | | |
| Domestic | \$ 362 | \$ 252 | \$ 102 |
| Foreign | 41 | 34 | 25 |
| Deferred | 21 | (70) | (16) |
| Provision for income taxes | \$ 424 | \$ 216 | \$ 111 |

Income before income taxes and extraordinary loss included approximately \$205 million, \$223 million and \$176 million related to foreign operations in fiscal years 1998, 1997 and 1996, respectively.

The Company has not recorded a deferred income tax liability of approximately \$127 million for additional taxes that would result from the distribution of certain earnings of its foreign subsidiaries, if they were repatriated. The Company currently intends to reinvest indefinitely these undistributed earnings of its foreign subsidiaries.

The components of the Company's net deferred tax asset (included in other current assets) are as follows:

| <i>(in millions)</i> | <i>Fiscal Year Ended</i> | | |
|--|--------------------------|-------------------------|-------------------------|
| | <i>February 1, 1998</i> | <i>February 2, 1997</i> | <i>January 28, 1996</i> |
| Provisions for product returns and doubtful accounts | \$ 20 | \$ 31 | \$ 25 |
| Inventory and warranty provisions | 24 | 21 | 18 |
| Deferred service contract revenue | 124 | 107 | 53 |
| Other | (62) | (26) | (29) |
| Net deferred tax asset | \$ 106 | \$ 133 | \$ 67 |

The effective tax rate differed from statutory U.S. federal income tax rate as follows:

| <i>(in millions)</i> | <i>Fiscal Year Ended</i> | | |
|---|--------------------------|-------------------------|-------------------------|
| | <i>February 1, 1998</i> | <i>February 2, 1997</i> | <i>January 28, 1996</i> |
| U.S. federal statutory rate | 35.0% | 35.0% | 35.0% |
| Foreign income taxed at different rates | (4.6)% | (6.2)% | (6.0)% |
| Other | 0.6% | 0.2% | — |
| Effective tax rates | 31.0% | 29.0% | 29.0% |

NOTE 4—Joint Venture

During fiscal 1998, the Company and Newcourt Credit Group Inc. formed a joint venture, Dell Financial Services L.P. ("DFS"), to provide leasing and asset management services to the Company's customers. The Company has a 70% interest in DFS; however, as the Company does not exercise control over DFS, it accounts for the investment under the equity method. Dell Credit Company L.L.C., which is owned 50% by the Company and 50% by Newcourt, is the sole general partner of DFS and, as such, is liable for the obligations of DFS. Operations of DFS for fiscal year 1998 were not material to the Company.

NOTE 5—Financing Arrangements

During fiscal 1997, the Company entered into a \$100 million 364-day revolving credit facility and a \$150 million 3-year revolving credit facility. During fiscal 1998, the Company replaced the two separate facilities with one \$250 million 5-year revolving credit facility. Additionally during fiscal 1996, the Company entered into a transaction that gives the Company the ability to raise up to \$150 million through a receivables securitization facility. Commitment fees for each of these facilities are paid quarterly and are based on specific liquidity requirements. Commitment fees paid in both fiscal 1998 and 1997 were not material to the Company. At both February 1, 1998 and February 2, 1997, these facilities were unused.

Notes to Consolidated Financial Statements—continued

NOTE 6—Preferred Stock

The Company has the authority to issue 5 million shares of preferred stock, par value \$.01 per share.

Series A Convertible Preferred Stock—During fiscal 1996, the Company offered to pay a cash premium of \$8.25 for each outstanding share of Series A Convertible Preferred Stock that was converted to common stock. Holders of 1 million shares of Series A Convertible Preferred Stock elected to convert and, as a result, received an aggregate of approximately 20 million shares of common stock and \$10 million in cash during fiscal 1996. During fiscal 1997, the remaining 60,000 shares of Series A Convertible Preferred Stock were converted into common stock in accordance with their terms, resulting in the issuance of an additional 1 million shares of common stock.

Series A Junior Participating Preferred Stock—In conjunction with the distribution of Preferred Share Purchase Rights (see Note 9 Preferred Share Purchase Rights), the Company's Board of Directors designated 200,000 shares of preferred stock as Series A Junior Participating Preferred Stock ("Junior Preferred Stock") and reserved such shares for issuance upon exercise of the Preferred Share Purchase Rights. At February 1, 1998 and February 2, 1997, no shares of Junior Preferred Stock were issued or outstanding.

NOTE 7—Common Stock

Authorized Shares—During fiscal 1998, the Company's stockholders approved an increase in the number of authorized shares of common stock to one billion from three hundred million at the end of fiscal 1997.

Stock Split—On each of March 6, 1998 and July 25, 1997, the Company effected a two-for-one common stock split by paying a 100% stock dividend to stockholders of record as of February 27, 1998 and July 18, 1997, respectively. All share and per share information has been retroactively restated in the Consolidated Financial Statements to reflect these stock splits.

Stock Repurchase Program—The Board of Directors has authorized the Company to repurchase up to 250 million shares of its common stock in open market or private transactions. During fiscal 1998 and fiscal 1997, the Company repurchased 69 million and 81 million shares of its common stock, respectively, for an aggregate cost of \$1.0 billion and \$503 million, respectively. The Company utilizes equity instrument contracts to facilitate its repurchase of common stock. At February 1, 1998 and February 2, 1997, the Company held equity instrument contracts that relate to the purchase of 50 million and 36 million shares of common stock, respectively, at an average cost of \$44 and \$9 per share, respectively. Additionally, at February 1, 1998 and February 2, 1997, the Company has sold put obligations covering 55 million and 34 million shares, respectively, at an average exercise price of \$39 and \$8, respectively. The equity instruments are exercisable only at expiration, with the expiration dates ranging from the first quarter of fiscal 1999 through the third quarter of fiscal 2000.

At February 2, 1997, certain outstanding put obligations contained net cash settlement or physical settlement terms thus resulting in a reclassification of the maximum potential repurchase obligation of \$279 million from stockholders' equity to put warrants. The outstanding put options at February 1, 1998 permitted net-share settlement at the Company's option and, therefore, did not result in a put warrant liability on the balance sheet. The equity instruments did not have a material dilutive effect on earnings per common share for fiscal 1998 or fiscal 1997.

NOTE 8—Benefit Plans

Incentive and Employee Stock Purchase Plans—The Dell Computer Corporation Incentive Plan (the “Incentive Plan”), which is administered by the Compensation Committee of the Board of Directors, provides for the granting of incentive awards in the form of stock options, stock appreciation rights (“SARs”), restricted stock, stock and cash to directors, executive officers and key employees of the Company and its subsidiaries, and certain other persons who provide consulting or advisory services to the Company.

Options granted may be either incentive stock options within the meaning of Section 422 of the Internal Revenue Code or nonqualified options. The right to purchase shares under the existing stock option agreements typically vests pro-rata at each option anniversary date over a five-year period. Stock options must be exercised within ten years from date of grant. Stock options are generally issued at fair market value. Under the Incentive Plan, each nonemployee director of the Company automatically receives nonqualified stock options annually.

The following table summarizes stock option activity:

| | <i>Fiscal Year Ended</i> | | | | | |
|----------------------------------|-----------------------------|--|-----------------------------|--|-----------------------------|--|
| | <i>February 1, 1998</i> | | <i>February 2, 1997</i> | | <i>January 28, 1996</i> | |
| <i>(share data in millions)</i> | <i>Number Of Shares</i> | <i>Weighted Average Exercise Price</i> | <i>Number Of Shares</i> | <i>Weighted Average Exercise Price</i> | <i>Number Of Shares</i> | <i>Weighted Average Exercise Price</i> |
| Outstanding at beginning of year | 113 | \$ 3.89 | 94 | \$ 2.10 | 90 | \$ 1.13 |
| Granted | 22 | \$ 27.21 | 43 | \$ 6.58 | 32 | \$ 3.91 |
| Canceled | (5) | \$ 6.19 | (7) | \$ 2.34 | (8) | \$ 1.02 |
| Exercised | (20) | \$ 3.02 | (17) | \$ 1.50 | (20) | \$ 1.05 |
| Outstanding at end of year | <u>110</u> | \$ 8.99 | <u>113</u> | \$ 3.89 | <u>94</u> | \$ 2.10 |
| Exercisable at year-end | 25 | \$ 11.90 | 19 | \$ 1.81 | 19 | \$ 1.30 |

The following is additional information relating to options outstanding as of February 1, 1998:

| <i>(share data in millions)</i> | <i>Options Outstanding</i> | | | <i>Options Exercisable</i> | | |
|---------------------------------|---------------------------------|-----------------------------|--|--|-----------------------------|--|
| | <i>Exercise Price Range</i> | <i>Number Of Shares</i> | <i>Weighted Average Exercise Price</i> | <i>Weighted Average Contractual Life (Years)</i> | <i>Number Of Shares</i> | <i>Weighted Average Exercise Price</i> |
| \$0.01-\$1.99 | 28 | \$ 1.16 | 5.8 | 12 | \$ 1.38 | |
| \$2.00-\$4.99 | 27 | \$ 3.61 | 7.5 | 7 | \$ 3.47 | |
| \$5.00-\$9.99 | 27 | \$ 6.16 | 8.3 | 4 | \$ 6.18 | |
| \$10.00-\$19.99 | 14 | \$ 14.08 | 8.9 | 2 | \$ 11.24 | |
| \$20.00-\$50.50 | 14 | \$ 36.00 | 9.4 | — | \$ — | |
| | <u>110</u> | | | <u>25</u> | | |

Notes to Consolidated Financial Statements—continued

During fiscal 1998, 1997 and 1996 the Company granted 1 million shares, 3 million shares and 6 million shares, respectively, of restricted stock. For substantially all restricted stock grants, at the date of grant, the recipient has all rights of a stockholder, subject to certain restrictions on transferability and a risk of forfeiture. Restricted shares typically vest over a seven-year period beginning on the date of grant and restrictions may not extend more than ten years from the date of grant. The Company records unearned compensation equal to the market value of the restricted shares on the date of grant and charges the unearned compensation to expense over the vesting period.

There were 10 million, 29 million and 68 million shares of common stock available for future grants under the Incentive Plan at February 1, 1998, February 2, 1997, and January 28, 1996, respectively.

The Company also has an employee stock purchase plan that qualifies under Section 423 of the Internal Revenue Code and permits substantially all employees to purchase shares of common stock. Participating employees may purchase common stock through payroll deductions at the end of each participation period at a purchase price equal to 85% of the lower of the fair market value of the common stock at the beginning or the end of the participation period. Common stock reserved for future employee purchases under the plan aggregated 13 million shares at February 1, 1998, 15 million shares at February 2, 1997, and 19 million shares at January 28, 1996. Shares issued under this plan were 2 million shares in fiscal 1998, 3 million shares in fiscal 1997 and 3 million shares in fiscal 1996.

The weighted average fair value of stock options at date of grant was \$16.26, \$3.73, and \$2.22 per option for options granted during fiscal years 1998, 1997, and 1996, respectively. Additionally, the weighted average fair value of the purchase rights under the employee stock purchase plan granted in fiscal years 1998, 1997, and 1996 was \$6.11, \$2.04, and \$1.01 per right, respectively. The weighted average fair value of options was determined based on the Black-Scholes model, utilizing the following weighted average assumptions:

| | <i>Fiscal Year Ended</i> | | |
|------------------------------|--------------------------|-------------------------|-------------------------|
| | <i>February 1, 1998</i> | <i>February 2, 1997</i> | <i>January 28, 1996</i> |
| Expected term: | | | |
| Stock options | 5 years | 5 years | 5 years |
| Employee stock purchase plan | 6 months | 6 months | 6 months |
| Interest rate | 6.28% | 6.40% | 6.20% |
| Volatility | 54.92% | 56.54% | 57.36% |
| Dividends | 0% | 0% | 0% |

Had the Company accounted for its stock option and stock purchase plans by recording compensation expense based on the fair value at the grant date on a straight line basis over the vesting period, stock-based compensation costs would have reduced pretax income by \$100 million (\$69 million, net of taxes), \$22 million (\$16 million, net of taxes) and \$8 million (\$6 million, net of taxes) in fiscal 1998, 1997 and 1996, respectively. The pro forma effect on diluted earnings per common share would have been a reduction of \$0.09, \$0.02 and \$0.01 for fiscal years 1998, 1997 and 1996, respectively. The pro forma effect on basic earnings per common share would have been a reduction of \$0.11, \$0.02 and \$0.01 for fiscal years 1998, 1997 and 1996, respectively.

401(k) Plan—The Company has a defined contribution retirement plan that complies with Section 401(k) of the Internal Revenue Code. Substantially all employees in the U.S. are eligible to participate in the plan. The Company matches 100% of each participant's voluntary contributions, subject to a maximum Company contribution of 3% of the participant's compensation. During each of fiscal 1998, fiscal 1997 and fiscal 1996, the Company made discretionary contributions for every eligible employee, regardless of whether the employee was a plan participant, equal to 2% of the employee's actual earnings during calendar years 1997, 1996 and 1995, respectively. The Company's matching and discretionary contributions during fiscal years 1998, 1997 and 1996 were \$20 million, \$13 million and \$10 million, respectively.

NOTE 9—Preferred Share Purchase Rights

On November 29, 1995, the Company's Board of Directors declared a dividend of one Preferred Share Purchase Right (a "Right") for each outstanding share of common stock. The distribution of the Rights was made on December 13, 1995, to the stockholders of record on that date. Each Right entitles the holder to purchase one eight-thousandth of a share of Junior Preferred Stock at an exercise price of \$225 per one-thousandth of a share.

If a person or group acquires 15% or more of the outstanding common stock, each Right will entitle the holder (other than such person or any member of such group) to purchase, at the Right's then current exercise price, the number of shares of common stock having a market value of twice the exercise price of the Right. If exercisable, the Rights contain provisions relating to merger or other business combinations. In certain circumstances, the Board of Directors may, at its option, exchange part or all of the Rights (other than Rights held by the acquiring person or group) for shares of common stock at an exchange rate of one share of common stock for each Right.

The Company will be entitled to redeem the Rights at \$.001 per Right at any time before a 15% or greater position has been acquired by any person or group. Additionally, the Company may lower the 15% threshold to not less than the greater of (a) any percentage greater than the largest percentage of common stock known by the Company to be owned by any person (other than Michael S. Dell) or (b) 10%. The Rights expire on November 29, 2005.

Neither the ownership nor the further acquisition of common stock by Michael S. Dell will cause the Rights to become exercisable or nonredeemable or will trigger the other features of the Rights.

NOTE 10—Commitments, Contingencies and Certain Concentrations

Lease Commitments—During fiscal 1998, the Company entered into a master lease facility ("Facility"), which provides for the ability to lease certain real property, buildings and equipment to be constructed or acquired. The lessor has agreed to fund up to \$227 million under this Facility. Rent obligations for the buildings commence on various dates.

The lease has an initial term of five years with an option to renew for two successive years, subject to certain conditions. The Company may, at its option, purchase the buildings during or at the end of the lease term for 100% of the then outstanding amount expended by the lessor to construct the buildings. If the Company does not exercise the purchase option, the Company will guarantee a residual value of the buildings as determined by the agreement (approximately \$36 million at February 1, 1998).

The Company leases other property and equipment, manufacturing facilities and office space under noncancelable leases. Certain leases obligate the Company to pay taxes, maintenance and repair costs.

Future minimum lease payments under all noncancelable leases as of February 1, 1998 are as follows: \$21 million in 1999; \$19 million in 2000; \$16 million in 2001; \$9 million in 2002; \$7 million in 2003; and \$29 million thereafter. Rent expense totaled \$36 million, \$33 million and \$22 million for the fiscal years ended 1998, 1997 and 1996, respectively.

Legal Matters—The Company is subject to various legal proceedings and claims arising in the ordinary course of business. The Company's management does not expect that the outcome in any of these legal proceedings, individually or collectively, will have a material adverse effect on the Company's financial condition, results of operations, or cash flows.

Notes to Consolidated Financial Statements—continued

Certain Concentrations—All of the Company's foreign exchange and interest rate derivative instruments involve elements of market and credit risk in excess of the amounts recognized in the financial statements. The counterparties to financial instruments consist of a number of major financial institutions. In addition to limiting the amount of agreements and contracts it enters into with any one party, the Company monitors its positions with and the credit quality of the counterparties to these financial instruments. The Company does not anticipate nonperformance by any of the counterparties.

The Company's marketable securities are placed with high quality financial institutions and other companies, and the Company currently invests primarily in equity securities and debt instruments that have maturities of less than three years. Management believes no significant concentration of credit risk for marketable securities exists for the Company.

The Company has business activities with large corporate, government, medical and education customers, small-to-medium businesses and individuals and value-added resellers. Its receivables from such parties are well diversified.

The Company purchases a number of components from single sources. In some cases, alternative sources of supply are not available. In other cases, the Company may establish a working relationship with a single source, even when multiple suppliers are available, if the Company believes it is advantageous to do so due to performance, quality, support, delivery, capacity or price considerations. If the supply of a critical single-source material or component were delayed or curtailed, the Company's ability to ship the related product in desired quantities and in a timely manner could be adversely affected. Even where alternative sources of supply are available, qualification of the alternative suppliers and establishment of reliable supplies could result in delays and a possible loss of sales, which could affect operating results adversely.

NOTE 11—Geographic Area Information

The Company operates in one principal business segment across geographically diverse markets. The Americas region includes the United States, Canada and Latin America. Substantially all of the Americas' operating results and identifiable assets are in the United States. Transfers between geographic areas are recorded using internal transfer prices set by the Company.

| (in millions) | Fiscal Year 1998 | | | | |
|------------------------------------|------------------|----------|---------------------------|--------------|--------------|
| | Americas | Europe | Asia-Pacific and Japan | Eliminations | Consolidated |
| Sales to unaffiliated customers | \$ 8,531 | \$ 2,956 | \$ 840 | \$ — | \$ 12,327 |
| Transfers between geographic areas | 67 | 17 | — | (84) | — |
| Total sales | \$ 8,598 | \$ 2,973 | \$ 840 | \$ (84) | \$ 12,327 |
| Operating income | \$ 1,152 | \$ 255 | \$ 33 | \$ — | \$ 1,440 |
| Corporate expenses | | | | | (124) |
| Total operating income | | | | | \$ 1,316 |
| Identifiable assets | \$ 1,363 | \$ 605 | \$ 172 | \$ — | \$ 2,140 |
| General corporate assets | | | | | 2,128 |
| Total assets | | | | | \$ 4,268 |

| <i>(in millions)</i> | <i>Fiscal Year 1997</i> | | | | |
|------------------------------------|-------------------------|---------------|-----------------------------------|---------------------|---------------------|
| | <i>Americas</i> | <i>Europe</i> | <i>Asia-Pacific and Japan</i> | <i>Eliminations</i> | <i>Consolidated</i> |
| Sales to unaffiliated customers | \$ 5,279 | \$ 2,004 | \$ 476 | \$ — | \$ 7,759 |
| Transfers between geographic areas | 50 | 32 | — | (82) | — |
| Total sales | \$ 5,329 | \$ 2,036 | \$ 476 | \$ (82) | \$ 7,759 |
| Operating income (loss) | \$ 609 | \$ 193 | \$ (6) | \$ — | \$ 796 |
| Corporate expenses | | | | | (82) |
| Total operating income | | | | | 714 |
| Identifiable assets | \$ 903 | \$ 390 | \$ 125 | \$ — | \$ 1,418 |
| General corporate assets | | | | | 1,575 |
| Total assets | | | | | \$ 2,993 |

| <i>(in millions)</i> | <i>Fiscal Year 1996</i> | | | | |
|------------------------------------|-------------------------|---------------|-----------------------------------|---------------------|---------------------|
| | <i>Americas</i> | <i>Europe</i> | <i>Asia-Pacific and Japan</i> | <i>Eliminations</i> | <i>Consolidated</i> |
| Sales to unaffiliated customers | \$ 3,474 | \$ 1,478 | \$ 344 | \$ — | \$ 5,296 |
| Transfers between geographic areas | 66 | 192 | — | (258) | — |
| Total sales | \$ 3,540 | \$ 1,670 | \$ 344 | \$ (258) | \$ 5,296 |
| Operating income (loss) | \$ 285 | \$ 171 | \$ (21) | \$ — | \$ 435 |
| Corporate expenses | | | | | (58) |
| Total operating income | | | | | 377 |
| Identifiable assets | \$ 867 | \$ 409 | \$ 123 | \$ — | \$ 1,399 |
| General corporate assets | | | | | 749 |
| Total assets | | | | | \$ 2,148 |

Notes to Consolidated Financial Statements—continued

NOTE 12—Supplemental Consolidated Financial Information

| <i>(in millions)</i> | <i>February 1, 1998</i> | <i>February 2, 1997</i> |
|--|-------------------------|-------------------------|
| Supplemental Consolidated Statement of Financial Position Information | | |
| Accounts receivable: | | |
| Gross accounts receivable | \$ 1,514 | \$ 934 |
| Allowance for doubtful accounts | (28) | (31) |
| | \$ 1,486 | \$ 903 |
| Inventories: | | |
| Production materials | \$ 189 | \$ 223 |
| Work-in-process and finished goods | 44 | 28 |
| | \$ 233 | \$ 251 |
| Property, plant and equipment: | | |
| Land and buildings | \$ 137 | \$ 133 |
| Computer equipment | 135 | 104 |
| Office furniture and fixtures | 45 | 32 |
| Machinery and other equipment | 126 | 59 |
| Leasehold improvements | 66 | 46 |
| Total property, plant and equipment | 509 | 374 |
| Accumulated depreciation and amortization | (167) | (139) |
| | \$ 342 | \$ 235 |
| Accrued and other liabilities: | | |
| Accrued compensation | \$ 236 | \$ 113 |
| Deferred revenue on warranty contracts | 193 | 126 |
| Book overdrafts | 146 | 27 |
| Accrued warranty costs | 139 | 111 |
| Taxes other than income taxes | 122 | 74 |
| Other | 218 | 167 |
| | \$ 1,054 | \$ 618 |

| <i>(in millions)</i> | <i>Fiscal Year Ended</i> | | |
|--|--------------------------|-------------------------|-------------------------|
| | <i>February 1, 1998</i> | <i>February 2, 1997</i> | <i>January 28, 1996</i> |
| Supplemental Consolidated Statement of Income Information | | | |
| Research, development and engineering expenses: | | | |
| Research and development expenses | \$ 145 | \$ 88 | \$ 62 |
| Engineering expenses | 59 | 38 | 33 |
| | \$ 204 | \$ 126 | \$ 95 |
| Financing and other: | | | |
| Interest expense | \$ (3) | \$ (7) | \$ (15) |
| Investment and other income, net | 55 | 40 | 21 |
| | \$ 52 | \$ 33 | \$ 6 |
| Supplemental Consolidated Statement of Cash Flows Information | | | |
| Changes in operating working capital accounts: | | | |
| Accounts receivable, net | \$ (638) | \$ (200) | \$ (196) |
| Inventories | 16 | 177 | (138) |
| Accounts payable | 638 | 581 | 59 |
| Accrued and other liabilities | 644 | 141 | 126 |
| Other, net | (131) | (40) | (46) |
| | \$ 529 | \$ 659 | \$ (195) |
| Supplemental cash flow information: | | | |
| Income taxes paid | \$ 274 | \$ 178 | \$ 117 |
| Interest paid | \$ 3 | \$ 12 | \$ 17 |

NOTE 13—Unaudited Quarterly Results

The following tables contain selected unaudited Consolidated Statement of Income and stock price data for each quarter of fiscal 1998 and 1997.

| <i>(in millions, except per share data)</i> | <i>Fiscal Year 1998</i> | | | |
|---|-------------------------|--------------------|--------------------|--------------------|
| | <i>4th Quarter</i> | <i>3rd Quarter</i> | <i>2nd Quarter</i> | <i>1st Quarter</i> |
| Net revenues | \$ 3,737 | \$ 3,188 | \$ 2,814 | \$ 2,588 |
| Gross margin | \$ 822 | \$ 718 | \$ 624 | \$ 558 |
| Income before extraordinary loss | \$ 285 | \$ 248 | \$ 214 | \$ 198 |
| Net income | \$ 285 | \$ 248 | \$ 214 | \$ 198 |
| Income before extraordinary loss per common share(a): | | | | |
| Basic | \$ 0.44 | \$ 0.38 | \$ 0.32 | \$ 0.29 |
| Diluted | \$ 0.40 | \$ 0.34 | \$ 0.29 | \$ 0.27 |
| Weighted average shares outstanding(a): | | | | |
| Basic | 641 | 653 | 663 | 675 |
| Diluted | 706 | 721 | 729 | 734 |
| Stock sales prices per share(a): | | | | |
| High | \$ 50 17/32 | \$ 51 15/16 | \$ 43 3/8 | \$ 23 |
| Low | \$ 35 | \$ 36 1/2 | \$ 22 1/8 | \$ 14 31/32 |

Notes to Consolidated Financial Statements—continued

| <i>(in millions, except per share data)</i> | Fiscal Year 1997 | | | |
|---|------------------|-------------|-------------|-------------|
| | 4th Quarter | 3rd Quarter | 2nd Quarter | 1st Quarter |
| Net revenues | \$ 2,412 | \$ 2,019 | \$ 1,690 | \$ 1,638 |
| Gross margin | \$ 524 | \$ 450 | \$ 373 | \$ 319 |
| Income before extraordinary loss | \$ 188 | \$ 149 | \$ 112 | \$ 82 |
| Net income | \$ 188 | \$ 145 | \$ 103 | \$ 82 |
| Income before extraordinary loss per common share(a): | | | | |
| Basic(b) | \$ 0.28 | \$ 0.22 | \$ 0.15 | \$ 0.11 |
| Diluted(c) | \$ 0.25 | \$ 0.20 | \$ 0.14 | \$ 0.10 |
| Weighted average shares outstanding(a): | | | | |
| Basic | 673 | 700 | 716 | 727 |
| Diluted | 744 | 763 | 783 | 783 |
| Stock sales prices per share(a): | | | | |
| High | \$ 18 3/32 | \$ 11 3/32 | \$ 7 5/32 | \$ 5 27/32 |
| Low | \$ 9 29/64 | \$ 6 33/64 | \$ 5 3/64 | \$ 3 5/16 |

(a) Earnings per common share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly per common share information may not equal the annual earnings per common share. All share, per share and stock price information has been retroactively restated to reflect the two-for-one split of the common stock in March 1998 and July 1997.

(b) Excludes extraordinary loss of \$0.01 and \$0.01 basic earnings per common share for the third and second quarter, respectively, of fiscal 1997.

(c) Excludes extraordinary loss of \$0.01 and \$0.01 diluted earnings per common share for the third and second quarter, respectively, of fiscal 1997.

NOTE 14—Subsequent Event

In March 1998, the Company filed a registration statement with the U.S. Securities and Exchange Commission related to \$500 million of debt securities. Presently, no securities under this registration are issued or outstanding.

To the Board of Directors and Stockholders of Dell Computer Corporation

In our opinion, the accompanying consolidated statement of financial position and the related consolidated statements of income, of cash flows and stockholders' equity present fairly, in all material respects, the financial position of Dell Computer Corporation and its subsidiaries at February 1, 1998 and February 2, 1997, and the results of their operations and their cash flows for each of the three fiscal years in the period ended February 1, 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based upon our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse LLP

Austin, Texas

February 16, 1998

Dell Computer Corporation Senior Management

Board of Directors

Michael S. Dell

Chairman of the Board and
Chief Executive Officer,
Dell Computer Corporation

Donald J. Carty

Chairman of the Board,
President and
Chief Executive Officer,
AMR Corporation
and American Airlines Inc.

Committees: Finance, Audit, Nominating

Paul O. Hirschbiel Jr.

Consultant,
Cornerstone Equity Investors L.L.C.

Finance, Compensation

Michael H. Jordan

Chairman of the Board and
Chief Executive Officer,
CBS Corporation

Compensation, Nominating

Thomas W. Luce III

Of Counsel,
Hughes & Luce L.L.P.

Finance

Klaus S. Luft

Owner and President,
MATCH-Market Access for
Technology Services GmbH,
and Vice Chairman/
International Advisor,
Goldman Sachs Europe Limited
Finance, Audit

Claudine B. Malone

President,
Financial & Management
Consulting Inc.

Audit

Alex J. Mandl

Chairman of the Board and
Chief Executive Officer,
Teligent Inc.

Compensation

Michael A. Miles

Former Chairman of the Board
and Chief Executive Officer,
Philip Morris Companies Inc.

Compensation, Nominating

Executive Officers

Michael S. Dell

Chairman of the Board and
Chief Executive Officer

Morton L. Topfer

Vice Chairman

Kevin B. Rollins

Vice Chairman

Paul D. Bell

Vice President,
Americas Home and Small Business Group

G. Carl Everett Jr.

Senior Vice President,
Personal Systems Group

Jan Gesmar-Larsen

Senior Vice President and President,
Europe, Middle East and Africa

Thomas B. Green

Senior Vice President,
Law and Administration,
and Secretary

Jerome N. Gregoire

Vice President and
Chief Information Officer

Phillip E. Kelly

Vice President and President,
Asia-Pacific Group

Michael D. Lambert

Senior Vice President,
Enterprise Systems Group

Joseph A. Marengi

Senior Vice President,
Americas Relationship Group

D. Keith Maxwell

Vice President,
Worldwide Operations Group

Thomas J. Meredith

Senior Vice President and
Chief Financial Officer

Rosendo G. Parra

Vice President, Americas Public and
International Group

Charles H. Saunders

Vice President and President, Dell Japan

James M. Schneider

Vice President, Finance

Alex C. Smith

Vice President and Treasurer

Independent Accountants

Price Waterhouse LLP
Austin, Texas

Investor Data

Dell's common stock is traded on The Nasdaq National Market under the symbol DELL. For information on market prices of Dell's common stock, see Note 13 of Consolidated Financial Statements. On March 31, 1998, there were about 8,800 holders of record of the company's common stock, and more than 300,000 (estimated) beneficial holders.

Answers to most questions about Dell's products, operations, financial results and history can be found at the company's World Wide Web site at www.dell.com. For other financial data, contact:

Investor Relations
Dell Computer Corporation
One Dell Way
Round Rock, TX 78682-2222
(512) 728-7800

Copies of the Dell annual report on Form 10-K (without exhibits) for the fiscal year ended Feb. 1, 1998, are available without charge.

Information about about stock certificates, changing an address, consolidating accounts, transferring ownership or other stock matters can be obtained from:

American Stock Transfer and Trust Company
40 Wall St.
New York, NY 10005
(800) 937-5449
New York residents: (718) 921-8200

Dell has never paid cash dividends on its common stock. The company intends to retain earnings for use in its business and does not anticipate paying any cash dividends on common stock for at least the next 12 months.

Dell's 1998 annual shareholders meeting will be held at 9:00 a.m. on Friday, July 17, at the Austin Convention Center, 500 E. Cesar Chavez St., Austin, Texas.

Regional Headquarters

AMERICAS

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Fax: 44-1344-748-836

ASIA-PACIFIC

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1001 Stanhope House
734-738 King's Rd.
Quarry Bay, Hong Kong
852-2508-0500
Fax: 852-2887-2040

Dell and the Environment

While computers benefit society, Dell is constantly seeking innovative ways to minimize their effect on the environment. Among fiscal-1998 environmental accomplishments, Dell reduced its use of packaging in Europe by one-half; completed an upgrade of lighting in all company facilities in the Austin, Texas, area; and recycled 95 percent of waste generated by a new Americas manufacturing plant. Those and other efforts by Dell earned the company recognition from the U.S. Environmental Protection Agency and the Irish Power Supply Industry; the "Blue Angel" label from the German Federal Environmental Agency for three new computer models; Swedish "TCO '95" environmental certification, the first ever for computer products; and the "Best Workplace Recycling Award" from the Recycling Coalition of Texas.

Dell's 1998 annual report can be found on the World Wide Web at www.dell.com/corporate/investor/

Statements in this report that relate to future results and events are based on the company's current expectations. Actual results in future periods may differ materially from those currently expected or desired because of a number of risks and uncertainties, including the level of demand for personal computers; the intensity of competition; currency fluctuations; the cost of certain key components; and the company's ability to effectively manage product transitions and component availability, to minimize excess and obsolete inventory and to continue to expand and improve its infrastructure (including personnel and systems). Additional discussion of these and other factors affecting the company's business and prospects is contained in the company's periodic filings with the U.S. Securities and Exchange Commission.

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