Dell Inc.
Fiscal Year 2012 Fourth Quarter
Earnings Conference Call
February 21, 2012

OPERATOR:

Good afternoon and welcome to the Dell Inc. Fourth Quarter Fiscal Year 2012 Earnings Conference Call. I'd like to inform all participants this call is being recorded at the request of Dell.

As a reminder, Dell is also simulcasting this presentation with slides at www.dell.com/investor.

Later we will conduct a question and answer session. If you have a question, simply press star then one on your telephone keypad at any time during the presentation.

I'd like to turn the call over to Rob Williams, Head of Investor Relations.

Mr. Williams, you may begin.

ROB WILLIAMS:

Thanks, Regina.

With me today are Michael Dell, Brian Gladden and Steve Felice.

During Q4, we spoke with many of you about creating a more efficient earnings process. Based on that feedback, we're condensing our prepared comments, and expanding our Web deck. In Q1, we will add a key topics document. These materials, along with our Dell Shares vLog will be distributed well in advance of the call, and I encourage you to review them for additional perspective.

Next, I would like to remind you that all statements made during this call that relate to future results and events are forward-looking statements that are based on current expectations. Actual results and events could differ materially from those projected in the forward-looking statements because of a number of risks and uncertainties which are discussed in our annual and quarterly SEC filings, and in the cautionary statement in our press release and Web deck. We assume no obligation to update our forward-looking statements.

Please also note that will be referring to non-GAAP financial measures, including non-GAAP gross margin, operating expenses, operating income, net income, and earnings per share. Historical non-GAAP measures are reconciled to the most directly comparable GAAP measures in the Web deck posted in the Investor Relations section at Dell.com, and in our press release and 8-K filed today. I encourage you to review these documents.

Please also note that unless otherwise mentioned, all growth percentages refer to year-over-year progress.

Now, I will turn it over to Brian.

BRIAN GLADDEN: Thanks, Rob.

Fiscal Year 2012 was a strong year with great financial results for Dell. We also made important progress towards our key strategic initiatives. To highlight a few key examples, we continue to enhance our Enterprise Solutions capabilities by adding important intellectual property from acquired companies like SecureWorks, Compellent, and Force10.

We improved the cost position, execution, and profitability of our client business, building on the success of the past two years. We strategically invested in data center capacity, and solution center capabilities around the world.

And, finally, we significantly increased the number of solution sales specialists, and increased our enterprise R&D spending. These investments have helped to reshape our business, and will do so over the long-term.

For the year, consolidated revenue was $62.1 billion, and we delivered a record $18.6 billion in Enterprise Solutions and Services revenue. This business now represents 30 percent of revenue, and almost 50 percent of gross margin dollars. Consolidated operating income was 7.1 percent of revenue for the year, which is right on our long-term target. Cash flow from operations was $5.5 billion, up 39 percent.

From here, I'll refer to non-GAAP financial measures. Our full year results were inline with the outlook we provided in our November earnings call. In addition, at the beginning of the year, we said we would grow operating income 6 to 12 percent, and revenue 5 to 9 percent. Despite a challenging macro environment, we delivered 24 percent operating income growth, and 1 percent growth in revenue. We had record gross margin dollars, record operating income, and record non-GAAP earnings per share of $2.13 per share, which was up 34 percent.

While we're very pleased with our strategic progress, and our total year financial results, we did expect to do a bit better. There were a few areas in the fourth quarter that negatively impacted our gross margins, and I want to address those now.

We called out the global hard drive situation as a challenge for the quarter. And while we were effective in shaping demand, and pricing for hard drive cost increases, we were impacted by the available mix of drives. We prioritized high end drives to relationship customers, resulting in a product mix that was less profitable than normal in consumer and our after point of sale hard drive business.

Second, we worked through the remaining inventory of our previous generation phones, primarily impacting our consumer business. And, finally, our public business growth was impacted by continued weakness in U.S. public spending, which did not improve during the quarter. This resulted in a more significant sequential decline at margin pressure that we would typically see in the business in the fourth quarter. These three areas combined negatively impacted us by about $100 million.

Now, let's take a closer look at the fourth quarter P&L. Our key performance metrics, and additional details are provided for your reference on pages 8 and 9 in the Web deck. We delivered revenue of $16 billion for the quarter, which represents growth of 2 percent, and included a 14th week, which we estimate to be 3 percentage points of added growth.

Our gross margins were 21.7 percent, up 20 bases points year over year, but down 140 bases points sequentially. Consistent with our views going into the quarter, we effective managed operating expenses while continuing to fund strategic investments. For the quarter OPEX declined 10 bases points sequentially to 14.6 percent of revenue. Operating income was $1.1 billion or 7.1 percent of revenue. Interest and other expenses were $24 million driven by a $45 million gain on the sale of an investment. Our tax rate was 18.4 percent, driven by an increase in earnings in lower tax jurisdictions, and tax benefits that we don't anticipate to repeat in FY '13.

Earnings per share declined 4 percent to 51 cents per share. Our cash conversion cycle was a negative 36 days. Days receivable and days of inventory were flat relative to the third quarter. Days payable increased five days from the third quarter, primarily driven by the extra week that was in the fourth quarter.

We generated $1.4 billion in cash flow from operations, and ended the quarter with $18.2 billion in cash and investments. We repurchased $561 million in stock in the fourth quarter, and $2.7 billion, or 178 million shares for the year. As we enter the Fiscal 2013, we will maintain our disciplined approach to capital management, balancing cash needed for strategic investments, and repurchase activities.

Now, let's take a look at our lines of business, which you will find detailed on pages 13 through 18 of our deck. In the fourth quarter, we had record revenue in our Enterprise Solutions and Services business of $4.9 billion. Dell Services revenue grew 12 percent to $2.2 billion while improving markets. The total value of new services contracts signed is $1.9 billion on a trailing 12-month basis, and services backlog increased 11 percent to $15.5 billion led by contracted services backlog growth of 13 percent. We're very pleased with the progress of our services business as we head into FY '13.

Server and Networking revenue increased 6 percent. Total storage declined 13 percent while Dell-owned IP storage growth accelerated 33 percent to $463 million led by continued growth in all of our Dell IP categories, including Compellent, which saw over 60 percent sequential revenue growth.

Our desktop revenue was up 3 percent while our notebook revenue was up 1 percent. Premium products gained share year over year for the sixth consecutive quarter. Revenue for our software and peripherals business declined 4 percent for the quarter to $2.6 billion. This continues to be an area where we will see the effects of pruning the low margin elements of the portfolio.

Now, I'll turn it over to Steve to provide some background on our business units, and regional results.

STEVE FELICE: Thanks, Brian.

I'll turn now to the segment level performance, which is detailed on pages 20 through 23 of the Web deck.

Our commercial business approached $13 billion for the quarter, led by the strong performances in large enterprise and the small and medium business, which are up collectively 5 percent, with sequential OPINC growth of 6 percent. Large enterprise saw broad-based growth across both client and enterprise solutions and services. Our large enterprise services revenue increased 18 percent, as we continued to expand our vertical expertise and develop service solutions that are relevant to our customers business needs. Overall, demand continued to be softer in the US, but we did see good growth in both EMEA and APJ.

Public revenue was down slightly versus the prior year. Like last quarter, the primary drivers are the continued weakness in the US public and Western Europe sectors. For US federal we continue to see the slower spending pattern that we saw in Q3 after the government's fiscal year ended in September. Despite the overall revenue decline, though, services revenue increased 7 percent and our Dell IP storage revenue was up 32 percent. So, these are good examples of our government customers utilizing Dell solutions to help drive productivity.

Small and medium business saw strong growth across all regions, including the US. Enterprise solutions and services performance hit an all-time high during the quarter, generating growth of 18 percent. SMB also delivered the highest growth in services across all segments at 28 percent. The consumer business delivered 2.7 percent OpInc for the full year in line with the expectations that we set a year ago. But, in the fourth quarter results were mixed. Total revenue and margin weakness was largely concentrated in the US market, with a decline of 15 percent. We continued to see good progress in our high-end consumer systems, as our XPS notebook revenue increased 103 percent for the full year.

So, while we're disappointed in the Q4 profitability, we're pleased with the overall progress made during Fiscal Year 2012 as the consumer business grew OpInc by $259 million versus the previous year. Geographically we saw 10 percent growth in our Asia Pacific Region during Q4, including 15 percent growth in China, while EMEA growth accelerated to 8 percent, despite a challenging macro-economic background.

Growth countries continue to be a key driver, as well, growing 8 percent in Q4, and finishing the year up 12 percent. And with that I'll turn it back over to Brian to discuss our outlook.

BRIAN GLADDEN: Thanks, Steve.

Before I get to the outlook, let me just clarify, our cash flow from operations for the quarter was $1.8 billion. We're committed to executing our strategy, and are encouraged by the progress we've made in the Fiscal Year '12 results. We're shifting the mix of the company's revenue and margin, and our enterprise solutions and services business now account for 30 percent of our revenue up from 24 percent three years ago. We continue to make the necessary organic, and inorganic investments to accelerate this progress. This will be the same play we run in Fiscal Year '13.

For the next Fiscal Year we'll continue to focus on and prioritize operating income and cash flow as we make the necessary investments to reshape the company. We expect earnings per share for Fiscal Year '13 to exceed the record $2.13 we delivered in Fiscal Year '12. We also expect to deliver strong cash flow again with cash flow from operations exceeding our net income.

With our primary objective continuing to be one of reshaping the company for the future, combined with today's more uncertain environment, and our continued pruning activities, we are not providing a revenue outlook for the year. We feel this will allow us to focus both externally and internally on our key strategic priorities. We plan to update our longer-term outlook at our analyst meeting in June.

We're committed to a disciplined capital allocation strategy. This past year we allocated $2.7 billion to share repurchase, $2.6 billion to acquisitions in our enterprise portfolio, and increased our R&D and CAPEX by over 30 percent respectively. For Fiscal Year '13 we plan to allocate 10 to 30 percent of free cash flow to share repurchase and we expect to spend approximately $700 million on capital expenses.

We anticipate interest and other to average approximately $60 million a quarter and are projecting a full-year tax rate between 19 and 21 percent. For the first quarter, and consistent with what you've heard from others in the industry, we're still seeing some uncertainty around the hard disk supply and pricing. We expect drive, mixed management to continue to be challenging, but not as impactful as in the fourth quarter. We also anticipate good customer receptivity to the launch of our 12th generation server line, which will occur in the first quarter.

Over the past three years our first quarter revenue has averaged approximately a 4 percent sequential decline. When normalized for the 14th week, this decline is closer to 7 percent. We expect our first quarter revenue to be approximately in line with this adjusted historical decline.

Before we take questions, let me close with a few summary points. We remain fully committed to our strategy. Our FY '12 financial results were excellent, and we delivered record revenue, OP income, and earnings per share. There are a few areas we'd like to improve on from our fourth quarter results, and our Fiscal Year '13 outlook calls for continued mix shift to enterprise solutions and services, and a continued commitment to key investments in this area. And finally, we expect to see year-over-year growth in earnings per share. Now, let me turn it over to Rob to get the Q&A started.

ROB WILLIAMS: Thanks, Brian.

Just a quick reminder, please limit your questions to one with one follow up.

Regina, can we have the first question.

OPERATOR: Ladies and gentlemen, we will now begin the question and answer portion of today's call. If you have a question, please press star one on your telephone keypad. You will be announced prior to asking your question. If you would like to withdraw your question, press the pound key. Your first question comes from the line of Toni Sacconaghi with Sanford Bernstein.

TONI SACCONAGHI: Yes, thank you. I have one question and one follow-up, please. I'm still struggling a little bit on the forces at work on gross margin. I would have thought that pruning your software and peripherals portfolio would have helped margins on a sequential basis in the quarter. I would have thought DRAM pricing, which was down strongly would have helped margins in the quarter. Yet margins were down 140 basis points sequentially on higher volumes, suggesting that ex those other factors, maybe they were down 200 basis points. I struggle with; given that consumer is only 20 percent of the mix, that hard drives could have had that dramatic an impact. So, maybe you can go through each of the three reasons you cited, and attribute, or maybe refute the notion that pruning and other components were not a help? But, I'm still struggling with why gross margins were down so much.

BRIAN GLADDEN: Yes, Toni, I think the points you raised are all correct. I think those were things that would have contributed to positive momentum on gross margins. We clearly talked about coming into the quarter some of the concerns we had around margins, talking about the three items that we raised for hard disks, we had uncertainty coming into the quarter. We had significant inflation that came from the hard disk situation.

We did, effectively, raise prices to offset that. And the teams did a great job of getting supply to support the demand that we had. But, we just didn't get the mix of drives that we wanted. And it really forced us to sell lower or less configured, lower-end systems, and prevented us from accessing higher margin, more highly configured systems.

That played out across the portfolio, but especially in consumer and also I would say within our after market sales of hard disk within the S&P business. So, that's the one dynamic that I think we didn't fully understand coming into the quarter what that mix was going to do to us.

On the mobility side, we talked about -- we wrote off previous generation phones. That was about a $25 million impact in the quarter, quarter-on-quarter. And that is something that we would say is behind us now. And then on the public side, clearly talked about the weakened demand that we saw after the federal year-end in the US, especially. There was weaker demand. And I would say we saw bigger sequential decline in that business, which had a mix impact, but also I would say it was a more competitive environment within public and in some cases, market pricing was more aggressive. And we participated in parts of that and we participated in parts of that and that had an impact, as well.

So, those are three big things that I would call out, it's about $100 million. You could say 70 basis points gross margin, and there were other moving pieces as you look at other commodity prices and other dynamics in the quarter.

TONI SACCONAGHI: And then the follow-up, at your Analyst Day last year, you articulated a longer-term model of 5 to 7 percent revenue growth. I think ex-, the 53rd week, this year you were about flat. It sounds like given the way that you've given guidance for Fiscal '13, you're really not anticipating revenue growth again this year.

I was wondering, and I realize you're going to address this at your Analyst Day. But if that was truly meant to be longer-term guidance, and you seem hesitant to reiterate it, what has fundamentally changed about either the competitive environment, or about Dell's approach to the business that makes you less confident about talking about that, about talking about that as a longer-term goal, and also obviously in delivering against it in Fiscal '12 and Fiscal '13.

MICHAEL DELL: Yes, Toni, we'll give you a much better long-term view as we get into the June meeting. I think, clearly, it's a different demand environment, and there's more uncertainty as you look at things like Europe, as you look at some of the demand dynamics we've seen over the past year. That's number one. I think, in addition to that, we've been more aggressive, I think, in pruning. And I think that, to some extent, will continue for some period of time.

And by not giving you a real revenue outlook for the year, I think it gives us an ability to make the right decisions for the long term, continue this transformation, and make the investments we need, and not get so fixated on trying to deliver a specific revenue commitment.

TONI SACCONAGHI: Thank you.

ROB WILLIAMS: Thanks.

OPERATOR: Our next question comes from the line of Mark Moskowitz with J.P. Morgan.

MARK MOSKOWITZ: Thank you. The first question is around just the software strategy, if Michael could weigh in here, you were saying created new business units with new leadership, that trend. Can you just kind of help us understand how we should think about potential mileposts in terms of revenue as well as also the gross margin contribution?

MICHAEL DELL: Sure. You know, software obviously is playing an increasingly important role in the industry, and we've made a number of acquisitions around software, and systems management with KACE, and cloud integration with Boomi, and infrastructure virtualization, and orchestration with Scalent. And I think you'll see others as well fitting within the very similar framework that we've used in the past.

John Swainson is joining the company to lead this group for us, and we see a lot of opportunity in close adjacencies. We've had a lot of success with a number of the acquisitions that have been software related, and believe there is significant opportunity for us to build a big business here. I don't really have any revenue projections for you at this stage, but clearly it's a significant opportunity for us, and we're thrilled to have John joining the Dell team.

MARK MOSKOWITZ: Thank you.

And then the question is for Brian or Steve, I was trying to get a sense here in terms of the sales and marketing and the R&D dynamics as we look to 2013. Obviously, sales and marketing was a big push this past year, and it definitely supported your Enterprise Solutions growth, but we just want to get a better sense here, as we continue to hear more and more about the non-PC part of the business, do you guys have the flexibility maybe to pull back on the sales and marketing now, maybe drop some of that to the bottom line in 2013, and then maybe reallocate some of it to R&D to kind of support the software build out, and the other non-PC build outs?

STEVE FELICE: Yes. This is Steve. We did do a lot of investing. We had a lot of specialists. We added a lot to our capabilities with some of the acquisitions we've done. And towards the end of this year, we had already started to communicate that we felt we had added the investment that we could now grow into that in a productive way. So, you will see going forward a return to a more disciplined approach to the investment, to have the OPEX match the revenue. We think we have the resources in place to support some growth, especially in the Solutions and Enterprise areas. And that's really where we focused the investment. So, yes, you definitely won't see the same kind of growth that you saw last year in the operating expense.

OPERATOR: Our next question comes from the line of Katy Huberty with Morgan Stanley.

KATY HUBERTY: Thanks. Good afternoon. Just given the headwind in the quarter, can you talk about what the industry and Dell in particular are doing to help lighten the blow from HDDs on margins in future quarters, and specifically the hard disk drive companies have talked about long-term supply agreements, which would guarantee supply at certain capacities and price points. Are these contracts that you've entered into that help manage this situation over the next couple of quarters?

BRIAN GLADDEN: Katy, you know, clearly I think the teams did a very good job on our side to ensure that we get sufficient numbers of drives, and as we talked about, we maybe didn't get what we wanted. There were clearly cost increases that we absorbed. As you think about the quarter, we had an order of magnitude about $150 million of inflation from hard disk costs. And that was pretty consistent, probably, with what the market saw.

I'm not going to provide specific details of the commitments that we made. I think some of that is probably competitive information. But, that's sort of the dynamic. Our hope is, and as we look at the situation over the next couple of quarters, this is going to remain a bit challenging probably for the next two quarters, and begin to ease as we head into the second half. That's how we're thinking about it.

KATY HUBERTY: Okay. And then just a quick follow-up on the EPS guidance, many of your peers when they guide annually or multi-year, they're assuming some base level of acquisition. Does your guidance for earnings growth assume that you do some acquisitions for the year, or would those just be incremental EPS?

BRIAN GLADDEN: As we've talked to you about outlooks, we've always given you a combined view that includes everything we would expect to see. We obviously don't know all of that at this point, but we would intend to include that in the guidance and the outlook we've provided.

KATY HUBERTY: Okay. Thank you very much.

OPERATOR: Your next question comes from the line of Richard Gardner with Citigroup.

RICHARD GARDNER: Thank you. I would like to ask more of a product question, and I guess it's probably a question for Michael. But it seems like the server industry probably has a little more in terms of headwinds here. You've got the continued performance increases from Intel and all the people in the industry, virtualization. You've now got the server-based flash ramping. We've now had three years of very robust upgrade and consolidation activity within the base. And so, I would just be curious to get your outlook for growth for the server industry this year, and whether you believe that Romley will fuel a significant upgrade cycle, and why? Thank you.

MICHAEL DELL: Yes, I think what we're seeing is the replacement cycle actually accelerate a bit on servers, and the reason is that the gains in processor, and the combination effect of what's going on in I/O and solid state, flash, the 10 gig Romley, this is all allowing for much more intense virtualization loads. So, we're super-excited about our 12G server launch, which is coming in the first quarter. Obviously, virtualization is a big deal. We're simplifying systems management, really going after the bigger workloads, and accelerating the movement of work from minicomputer and mainframe environments onto our 12G platforms.

We also believe that Romley will help us more tightly drive a synergy with our recent Force10 acquisition. And so we've done a lot with flash, with solid state inside 12G. Stay tuned for the announcements, but we're very excited, and believe it's going to be another strong year for server, storage and networking. Remember, we're kind of changing the whole sale from being an individual product to effectively selling the entire data center.

RICHARD GARDNER: The follow-up, Michael, is that growth rates in servers have obviously accelerated dramatically during Fiscal '12, and during the fourth quarter in particular. Should we expect to see growth for the server business in particular re-accelerate?

MICHAEL DELL: Are you talking about unit growth?

RICHARD GARDNER: Revenue growth.

MICHAEL DELL: I think the product cycle will certainly be healthy for growth, and there are always value shifts that go on among the various ingredients. Overall, the enterprise business is doing quite well. We're seeing a lot of growth in storage. We had, in the quarter, 60 percent sequential growth in Compellent, overall our Dell IP storage was up 33 percent year over year, and 19 percent sequentially.

ROB WILLIAMS: And I would just add, we've kind of clicked along at mid-to-high single digits, and up around 10 percent most of this year at a consolidated level for the company, and with Romley coming in Q1, I think that you've got a reasonably nice set up, as we enter the first half of the year. So, it still remains to be seen. But, a lot of performance improvement that Michael called out.

Next question.

OPERATOR: Your next question comes from the line of Louis Miscioscia with Colin Stewart.

LOUIS MISCIOSCIA: Okay. Thank you.

If we look at your first quarter revenue guidance and let's just assume, even though I know you're not giving full-year guidance that you're around flat year-over-year. Others in the industry have talked about global IT growth of, let's say, 3 to 4 percent. So, let's say you end up being about flat. Can we assume then, because it would be really nice to understand how much that you are pruning out that that delta, if you're seeing the industry that way, is actually that 3 or 4 percent growth that the industry is getting that you're not.

BRIAN GLADDEN: Well, I mean, obviously, we're not going to give you a longer-term revenue view today. I think, as you think about the first quarter, I mean, we're just naturally calling the historical sequential first quarter versus fourth quarter dynamics, adjusted for the 14th week. I think what I would say is, as you look at the revenue dynamics and how we see demand for the year. I think the first half is going to be probably more challenging than the second half and we would expect demand to be a bit better as we move throughout the year. So, I think you could think about it that way, Lou.

LOUIS MISCIOSCIA: And a quick follow-up, in the storage area, obviously teams like you all are starting to do really well. Maybe just give us your thoughts on the competitive dynamics in the sense of who do you think you might be taking share from, because obviously it seems like you're going faster than the market? Thank you.

MICHAEL DELL: It's a pretty competitive market. We've seen great growth in SMB. Obviously we have a strong channel there. There's obviously some rebalancing as we position Compellent more to the higher end. But, the whole thing, as you said, 33 percent growth year-over-year is strong. We're 93 percent of our revenue now is our own IP. So, we're pretty much through the transition and believe we can growth this business quite nicely. But, it is a competitive environment. Obviously having a full portfolio of servers, storage, networking, services, and increasingly software is very helpful in many of the opportunities that we find.

LOUIS MISCIOSCIA: Good luck on the new year.

BRIAN GLADDEN: Thanks.

OPERATOR: Your next question comes from the line of Shannon Cross with Cross Research.

SHANNON CROSS: Thank you. My first question is, can you just provide some more color on in-demand, geographic vertical basis, anything you can give us in terms of what you're hearing from your customers and then possibly talk a bit about the linearity that you saw during the quarter.

BRIAN GLADDEN: I'll give you a little bit of the numbers, Shannon. And then Steve can give you some maybe insight into what he's seeing in the marketplace. As you think about regionally in the quarter obviously Asia Pacific was the fastest growing market. We were up 10 percent. EMEA was up 8 percent, which is clearly faster than the market and then Americas, driven by the US, was down and down 3 percent. For the total year APJ was up 15, EMEA was up 4, and Americas was down 4. So, that's the regional dynamics. I think when you look at the product lines, or the segment performance, clearly on the corporate side; between large enterprise and SMB we saw solid growth. And year-over-year was up 6 percent for SMB and up 5 percent for large enterprise and both of those were up mid-single digits for the year. So, those are the fundamental numbers, maybe Steve can give you some color.

STEVE FELICE: Well, you know, there's not a lot to add there. In Europe I would say we are seeing some definite growth ahead of what appears to be market conditions. So, I'm really pleased with what's going on in Europe. It's a good case where if we run the strategy right we're gaining both unit share and revenue share while our profit is accretive, both on a percentage basis and a dollar growth basis.

So, that's really a strong story. In Asia we're also seeing some similar dynamics. So, it really is limited to a few sectors like the US federal or some of the larger government entities in Western Europe, where we see the biggest headwinds. On the consumer side, we're seeing pretty healthy growth in most parts of the world. The hard drive rebalancing did get in the way in the US.

So, we probably could have grown more, but to add a little color to this, when we get the mix of drives, we have a series of customers that have a set contract with us that has a certain configuration and we fill that need first. So, it's really the transactional side of the business and even part of Toni's question. Consumer is completely transactional, but we have a lot of business within our small business and our large corporate, even pieces of that that are more transactional, in other words, it's really demand that comes in that day, where it's not under a contract. That's where we had to shape the drives. And we would normally sell a higher mix of capacity into those, if we had access to that. And that's what impacted both the consumer business from a demand and a margin basis in the US.

As a good example, we don't want to put a 350-gig drive on an XPS computer, because it's going to have a bad experience for the customer. So, it limited our ability of what mix we could sell. So, that impacted demand a little bit, and I think we'll see that continue to improve as each quarter goes by, where we have more visibility to the mix of the drives we're going to be seeing.

SHANNON CROSS: Okay. Great. And then, Michael, if you could just talk a little bit about your thoughts on the opportunities for ARM, both on the server side, as well as notebooks and tablets.

MICHAEL DELL: I think with Windows 8 obviously there's great excitement, particularly in the corporate space for us. And the addition of both capacitive touch capability, integrating that in with the software, and the ARM processor, pretty excited about Windows 8 and the effect that will have on demand, first with consumer, but then flowing pretty rapidly. There's a pretty strong appetite for a Windows tablet in enterprise, with the security and compatibility that customers kind of expect. On the server side, we've been experimenting with ARM now for I'd say more than a year. The challenge is really in the software stack. It's maturing. There's the LAMP stack, which is the obvious place to start. Competition isn't standing still there. And more competition there is certainly a good thing. And there's some interesting emerging. But, I think x86 still has an enormous lead in that space.

SHANNON CROSS: Thank you.

OPERATOR: Your next question comes from the Bill Shope with Goldman Sachs.

BILL SHOPE: Okay. Great. Thanks. Can you give us a bit more color into what you're seeing in terms of competitive pricing? I know you said you saw some competitive pricing in the public segment. But, outside of that what are you seeing and are most of your competitors attempting to pass along HDD costs, as well, or are there still some companies that are just hyper-focused on share gain.

STEVE FELICE: We haven't seen a substantial change in behavior over the last few quarters. There's pockets of aggressiveness, but I wouldn't call it a broad base. There is one concern that we've expressed over the last couple of quarters, where some of our competitors have been long in inventory and so we've seen older models get somewhat aggressive, and we've had to back off and let that flush its way through. We saw a little bit of that this quarter.

I know we've been able to successfully pass through the hard drive cost increases. And we still feel like we're in good competitive positions. So, I'd say in general that's probably happening across the board.

BILL SHOPE: All right. Thank you.

OPERATOR: Your next question comes from the line of Aaron Rakers with Stifel Nicholas.

AARON RAKERS: Yes, thanks for taking the question. I wanted to dive a little bit more in the model again, most of the questions have been asked. But, you know, just simplistically as we look at the year, you guys have basically come in slightly above your long-term target operating margin of 8 percent non-GAAP. Underpinning the $2.13 cent estimate plus for the full year, are you assuming that you're at or above that level again for Fiscal 2013? I'm trying to distinguish between operational OPEX management versus ongoing share repurchase in what you're factoring in.

BRIAN GLADDEN: To be fully transparent, I mean, I think as you look at the buyback that we've done this past year, and head into next year, the impact of the FY '12 share repurchase is about 6 cents of EPS benefit. You guys can do the math in terms of 10 to 30 percent buyback on a cash flow generation number for this coming year, and figure that out. I think we've given you a sense for tax rate being about the same year over year, and we've given you the interest and other. So, I think you can kind of get back to a view of how we're thinking about the operational performance of the business, and I think that's about it.

AARON RAKERS: Fair enough. And then the follow-up question for me would be, on the storage side, obviously you're burning through, and I would assume that you're pretty much all the way through the legacy EMC business. Compellent being up 60 percent sequentially, it seems to imply that you have what looks to be ongoing anemic growth, if you will, in your legacy EqualLogic business. I think there's been some transitions that you've worked through. Can you touch a little bit on EqualLogic specifically within that category?

BRIAN GLADDEN: Yes. I would say EqualLogic actually sequentially picked up nicely, and we had double-digit growth there, and we had good growth year over year as well in EqualLogic. So, it's picked up.

We talked about some of the challenges during the summer, and even after the third quarter. I think for the most part we launched a whole new set of products in the third quarter, and we're now in the process of upgrading all those -- moving to those new products. So, it actually feels pretty good.

RICHARD GARDNER: Thank you.

OPERATOR: Your next question comes from the line of Keith Bachman with Bank of Montreal.

KEITH BACHMAN: Hi. Thank you. Brian, for you if I could, on gross margins, your gross margin, if I net out that $100 million force was still down about 70 bases points sequentially, call it the mid-22s. If I think about your comments to previous questions, is that the right benchmark as we look to the potential April gross margins?

And if you could just talk a little bit about, will margins be flat, down or up, at least directionally, and what the forces are that persist there, because HDDs will be there. You've already commented on that. But I'm just trying to understand the benchmark relative to, say, the mid-22s that you reported in January versus what you might have in April.

BRIAN GLADDEN: Yes. I think, Keith, we've probably said about as much as we're going to say. Were not going to provide margin level guidance. I mean, I think the things we talked about for the most part we feel like we've got our arms around, clearly the mobility is not going to be an issue going forward. The hard disk situation should get better as we move throughout the first half of the year, and maybe that's about all we're going to give you at this point.

KEITH BACHMAN: Okay, Brian, could I at least just push on that, is there opportunities for improvement, or we should just think about all those forces persisting in the April quarter at least such that gross margins would be flattish?

BRIAN GLADDEN: Well, look, I think if you look at it over a multiple quarter dynamics here, we're growing the enterprise business much faster, and that is a higher margin part of the business, and we should, over a series of quarters, see expansion of gross margins because of that. We've been talking about that for a while, and we can start to show you actually that's happening, and that's a primary driver. I think you'll have some lumpiness with other issues in any given quarter.

KEITH BACHMAN: Okay. Thank you, Brian.

OPERATOR: Your next question comes from the line of Kulbinder Garcha with Credit Suisse.

KULBINDER GARCHA: Thanks. I just have a clarification. I think, Steve, you mentioned OPEX wouldn't grow at the same levels going forward for the next year. Could OPEX actually come down for any reason, or is Dell in a stage of, and maybe this is for Michael as well, where you have to invest to execute on this enterprise strategy. And then, on the issue of gross margins going forward, has anything changed in the pricing environment on the server side at all going forward? I think you've benefited just from the beneficial mix shift in servers over the last year, and I'm trying to see if there's any risk around that.

And then, finally, actually seeing them on the call, in terms of lower margin businesses you want to prune, is there a dollar number you can help us think about, is it $5 billion, is it $1 billion, any kind of range? I'm trying to think about how much that might hamper Dell's ability to grow revenues not just for the next year but for the next two or three years.

BRIAN GLADDEN: Kulbinder, it's Brian. I'll kick it off on the OPEX. I mean, I think there will be places, clearly, where we continue to invest. We've been investing in solutions and services, and adding solutions head count in both the R&D side as well as sales specialists. We'll continue to do that. We will continue to invest in the acquisitions that we've done, and in those acquisitions that we do going forward to build out capabilities there.

I think there are still opportunities to reduce OPEX in other parts of the business, and I think you've seen us do that as we've looked at a weaker demand environment over the last couple of quarters. So, I think it will be a blend, but we're not going to hesitate to make the investments we need to make to drive this strategy. That's a big part of what we're doing to transform the company.

STEVE FELICE: That's exactly right. The key thing is that we're starting to see the productivity benefits of the investments we made, and I think if you look at the year in balance we clearly did the right thing in investing in the business. That's what's driving the higher margins is our ability to sell a higher mix, and a higher solution set.

So, now we're just saying that we've got a more productive set of capabilities, and we can scale it better. But, as Brian said, we want to continue to invest in the business. So, as long as the demand environment allows it, we'll continue to add investments.

BRIAN GLADDEN: On your server margin question, I think we've done a nice job of changing the mix of where we play in the server business, and moving to more highly configured, higher end workloads within that space. I think that's driven a nice expansion of margins within the server business. We think that that will continue with our 12th generation products, we'll continue to do that. So, we feel pretty good about the overall sustainability of the profitability in the server business. And what was your third question, Kulbinder?

KULBINDER GARCHA: Sorry, on the pruning of businesses, just in terms of what's left, is that like a $5 billion number in revenue terms on an annual basis, $1 billion? I'm just trying to get a sense of how much more pruning Dell has left, realistically. And not just for the next year, I'm thinking of the next couple of years in terms of how much that might hamper your revenue growth?

BRIAN GLADDEN: Well, I would say, without giving you specifics, that we're through the majority of this. We told you about $3 billion this past year was what we were working our way through, and that's still a good number. IT would be a smaller number as we move forward. And primarily focused in the S&P business as the primary element that we move forward with.

KULBINDER GARCHA: Okay, thank you very much.

OPERATOR: Your next question comes from the line of Maynard Um with UBS.

MAYNARD UM: Hi, thank you. Can you just talk about how you're measuring the R&D and sales and marketing investments that you've made over the last year into the businesses, what metrics in particular are you looking at, and how that's tracking so far relative to your original expectations?

BRIAN GLADDEN: We've really bifurcated the way we think about OPEX, and clearly have begun to look at some of these product lines relative to competitive benchmarks. If you think about the storage business, you think about where we are on enterprise and total, and we've basically set some targets around the right levels of investment.

Clearly those teams have commitments around growth, they have commitments around the product portfolio, and launching new products, but I think we've got a real sense for what's required to be successful in these kinds of businesses. And we're committed to get there. And I think at the same point we're going to be tough in other parts of the business, whether it's in G&A or other, less profitable parts of the business, in terms of investment. And that's how we can fund those things.

MAYNARD UM: Well, I guess specifically to the specialists that you hired, how are you measuring those guys, and how is that in particular tracking?

STEVE FELICE: Yes, we have a series of key performance indicators and for competitive reasons I'm not going to share the details of them, but we can measure how much growth we're getting in the way we define a solution. We can measure the pipeline that's generated, that are multi line of business, for example. We can measure where we've added services content to the sale. We can look at the revenue, productivity, per specialist. So, we've got a number of metrics that we're pretty maniacally focused on. And so we know how we're progressing here and that's why I said earlier I'm pleased with the improvement in productivity as we go into this new year.

MAYNARD UM: Got it. And then, just lastly on the services business, can you just talk about what the big growth drivers are there and whether you think you are sufficiently scaled in that business? Thanks.

BRIAN GLADDEN: Yes, I think it's really across the board. I mean we've shared some of the progress we've made in new contracts on the non-support side of that business. But, I think we've also made progress with attach rates on support and overall really across the board some nice growth. In terms of scale, I think that's a place that you'll see us continue to invest to support that business. It's clearly one of the strategic priorities for us.

OPERATOR: Your next question comes from the line of Brian Marshall with ISI.

BRIAN MARSHALL: Great. Thanks, guys. I feel like your storage business, obviously Dell-owned IP storage has been doing extremely well, but we haven't seen much growth in that business as the third-party reseller comes down. So, we've kind of been hovering around $500 million in revs on a quarterly basis for quite some time. It seems to me that still commodity hardware represents a majority of the company's revenue. And that's been the case for obviously the past couple of years as we really tried to move to strategic revenue sources.

Can you discuss a little bit about how this is -- we're going to see similar trends that we've seen in storage in your networking, as well as your software business going forward, as we transition to more Dell-owned IP and stop the resell of third party. And then the follow up question is could you give us the unit number, as well. Thank you.

BRIAN GLADDEN: Yes, Brian, on the third party storage, on the total year that was down about 64 percent. We still have some more work to do there as you move into the first quarter. It was down in the fourth quarter 83 percent, and there is still a fair amount from a comparison standpoint in prior year first-quarter results. So, as we head into the second half of the year, we're pretty comfortable that we'll be completely through that. Probably even into the second quarter. And we'll have overall storage business begin to move forward in a growth mode. As you think about that model, it's really almost the same exact framework we would expect to see in the networking business. And as that gets to a scale that's larger, we'll begin to give you a little bit more visibility to that and probably in the analyst meeting, as well.

ROB WILLIAMS: Yes, Brian. I would just add that the focus is clearly on continuing to add Dell intellectual property that we think is disruptive and that can provide real value for our customers. So, if you look at this past year, you know there's a lot of clear indications of that in SecureWorks, in Compellent, and in some of the other acquisitions that we made, Force 10 and then the integration of things like Ocarina, and Exanet into our storage portfolio.

So, no question that we're going to continue to be in the end-user computing business for the foreseeable future, a long time to come and it's a great business to be in, if we can grow it appropriately and attach the services and kind of drive that business appropriately. So, that's kind of how we're thinking about it.

BRIAN MARSHALL: Sure, understood. Thank you. And then it number if possible?

ROB WILLIAMS: I don't think we disclose units anymore. We moved off of that about a year ago.

BRIAN MARSHALL: Thanks, guys.

OPERATOR: Our final question will come from the line of Brian Alexander with Raymond James.

BRIAN ALEXANDER: Thanks, Brian. Based on the information you've given on buy-backs and other income, and tax rate, et cetera, it's still possible to drive EPS growth without driving growth in operating income. So, it's still not clear to me whether you expect to drive operating income growth in Fiscal '13 and I'm still confused as to why you aren't specifically discussing an OP income growth objective for the year, whereas last year you did?

BRIAN GLADDEN: Well, we spend some time benchmarking and looked at peer companies and what they do, and we were really the only company out there providing operating income outlooks. So, we decided to be consistent with other companies. So, that's why we moved to EPS.

I think your math is right. I think give everything we see right now, as we head into the year, that's the number that we're calling and I think as we move throughout the year and things become a little bit more certain around the demand environment, around where we are in the investments we need to make, we'll obviously give you more clarity on that.

But, we do think new can grow earnings per share, and that's our focus.

BRIAN ALEXANDER: All right. Maybe just one final follow-up if I could. In terms of capital allocation, you talked about buy backs at 10 to 30 percent of cash flow. You talked about CAPEX for the year. Can you say whether Dell is more seriously considering the issuance of a dividend, and if not what are the key arguments against a dividend, as you talk about this option with your board, given the company is generating a lot of cash. It's pretty consistent and you're sitting on a large pile of cash, as well? Thanks.

BRIAN GLADDEN: I think we talked about this last quarter in a specific question. And I would just say that the one big area of uncertainty that we obviously have to manage through and this is something we think about and talk about from time to time with the board is really around US liquidity and access to capital in the US. And as that gets clearer, I think we would obviously be in a position to talk more about that. But, that's probably the biggest thing that we think through is as we consider that alternative.

BRIAN ALEXANDER: Okay. Thanks.

OPERATOR: Ladies and gentlemen, this does conclude today's conference. Thank you all for participating. And you may now disconnect.

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