Dell Incorporated

Moderator: Robert Williams
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Operator: Good afternoon and welcome to the Dell, Inc. Second Quarter Fiscal Year 2010 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 anytime during the presentation.

I'd like to turn the call over to Rob Williams, Director of Investor Relation. Mr. Williams, you may begin.

Robert Williams: Thanks, Christian. With me today are Chairman and CEO, Michael Dell, and CFO, Brian Gladden. Brian will review our second quarter results, then Michael will follow with his perspective. When we get to Q&A, please limit your questions to one with one follow up.

Our investor relations activities for the balance of this year include the CitiGroup Technology Conference in New York in early September. We have a group investor meeting with Michael and Brian later in the month and two events in December including the CSFB Technology Conference and the Raymond James IT Supply Chain Conference.

I'd like to remind you that all growth comparisons made on this call are year over year unless otherwise stated and that all statements made during this call that relate to future results and events are forward looking statements that are based on our current expectations. Actual results and events could differ materially from these 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 contained in our press release and on our website. We assume no obligation to update our forward looking statements.

I'd now like to turn it over to Brian.

Brian Gladden: Thanks, Rob. We're generally pleased with the results of our second quarter, we believe that they demonstrate continued strong execution and broad progress on key initiatives we've shared over the last few quarters, specifically our cost reduction programs have never been more crucial than during this weaker demand environment.

Our results are driven by accelerating COGS improvements including better manufacturing efficiencies, continued OpEx controls and disciplined commercial execution. We also should highlight very strong working capital results for the quarter.

Michael will talk about relatively solid aggregate first half performance and I'd just like to reiterate that we're still in a very tough environment with weak demand continuing and we have a lot of work to do to continue to transform the company.

So let's get right into the P&L and key performance metrics that you'll find on pages six and seven of the posted web deck.

Revenue was down 22 percent to $12.8 billion on unit shipments that were down 14 percent. Sequentially, revenue was up three percent versus the first quarter with unit shipments up 10 percent.

This sequential improvement is consistent with our view that our demand environment has stabilized and while still mixed globally and by segment, it is improving somewhat. Gross margins were 18.7 percent. Solid progress on our COGS initiatives, disciplined pricing, particularly in July and a buyout of a revenue sharing agreement with a vendor and growth in enterprise products more than offset the pressure we saw from component costs, competitive pricing and client mixed dynamics.

The vendor transaction was worth about 50 basis points in the rate. Much of the COGS progress was related to manufacturing and logistics actions associated with our $4 billion cost savings initiatives. I'll cover these items in more detail in a moment.

OpEx was down 14 percent and was 13.5 percent of revenue. Organizational effectiveness expenses or OE was $87 million or four cents after tax with a majority of this expense related to OpEx.

Excluding the impact of $73 million in costs related to OE in Q2, adjusted OpEx was down $347 million or 17 percent year over year.

Intangibles amortization was $40 million and primarily affected our COGS.

Expense related to our broad performance-based long-term compensation plan, which is primarily equity, was $92 million split roughly 15 percent in COGS and 85 percent in OpEx.

Financing and Other Income was negative $42 million, driven in part from lower investment yield and higher interest expense related to the $1.5 billion in debt issuances we've done this year.

Our tax rate for the second quarter was 25 percent and overall GAAP earnings per share were 24 cents.

We had a strong cash quarter. Referring to slides eight and nine in the web deck, we generated $1.1 billion in cash flow from operations. Our cash conversion cycle improved seven days sequentially to a negative 35 days. As we've said, we continue to see opportunities to sustain and even improve our cash conversion cycle.

For the quarter, receivables increased eight days as a result of an increased mix of public and consumer retail related to back to school, though the quality of aged receivables in the quarter improved.

Payables increased to 84 days, driven by structural improvements in our supply chain and our transition to contract manufacturing. We continue to believe that over time we can generate cash flow from operations in excess of net income and that we can operate our cash conversation cycle at negative 30 days or better.

Turning to the balance sheet on slide 10. We ended the quarter with $12.7 billion in cash and investments and after improvements in the capital markets in June, we issued $1 billion in three and 10 year notes. We'll continue to monitor the overall capital and financial markets for any future cash needs.

Referring to slide 11, we're pleased with our progress in Dell Financial Services. As you know, we've been actively working this business over the past several quarters to reduce risk, improve returns, and diversify our exposure. And we're seeing the results of those efforts in the results of DFS.

During the quarter we saw improvements in managed portfolio delinquency and loss rates, but we remain cautious. Additionally, we continue to take actions that will further reduce our business exposure to specific partners in Q3.

Our cost-out initiatives played a critical role in our second quarter financial performance, specifically, let me share with you some of the key details of our COGS initiatives. We continue to make progress in our product redesign cost reduction programs, which you can see on slide 12.

Although we're pleased with these results, the good news is that we still have significant work and opportunity in this area.

In supply chain 2.0, our goal is to optimize our global supply chain to effectively serve our different customers around the world. Earlier this year we shifted to a segmented supply chain strategy that provides different ways of fulfilling customer's orders in creating differentiated value aligned to their specific needs.

We'll continue to balance our configure-to-order supply chain capabilities with significant utilization of contract manufacturing.

Approximately 40 percent of our volume is now going to contract manufacturing as of the end of the second quarter, and this will continue to grow.

As mentioned earlier, our efforts in optimizing manufacturing and logistics contributed to the sequential uplift in gross margins during the quarter, as we held on to these benefits, as opposed to passing them through to the customer base.

As I've said before, these realized savings may not be linear and we may choose to reinvest some or all of these benefits in the business.

Our business units had mixed results in the quarter and some are seeing better market conditions than others. The business unit results can be found on pages 13 through 16 of the web deck.

Large enterprise had a revenue decline of 32 percent and three percent decline sequentially to $3.3 billion. Operating income as a percentage of revenue was down 20 basis points to 5.2 percent, driven by global demand weakness and aggressive pricing activities on the demand we do see in the market right now.

Despite this, we continue to invest in our enterprise products, service and sales capabilities to help customers drive down the total cost of ownership and we're well positioned to benefit from a return to more normal demand in this segment.

Public was the best performing commercial business this quarter with revenue down 16 percent and up 20 percent sequentially to $3.8 billion.

Seasonal growth in our education segment was a key contributor to the improvement.

Operating profit dollars were up 16 percent, while operating income percent was up 280 basis points as we exercised pricing and OpEx discipline.

We remain focused on tailoring vertical solutions for our unique customer base in Public and balancing our geographic expansion by leveraging best practices.

Our small and medium business revenue was down 29 percent and five percent sequentially to $2.8 billion in the quarter. With IT demand strongest in Asia and weaker in EMEA where it appears that much of the industry demand was at the lower end of the product portfolio.

Operating income percent was up 40 basis points as we managed to improve gross margins despite the weak demand. Our efforts in SMB are still centered on delivering high value offerings and expanding our relationships through increased coverage.

Our consumer business posted a 17 percent year over year increase in unit volume and revenue of $2.9 billion, up two percent sequentially and nine percent decline from last year.

Operating income was $89 million, including a $53 million benefit from the vendor transaction we talked about. Similar transactions could appear periodically and as we work to expand sources of revenue and margin in this business, we will see this variability in margins.

This is similar to the dynamics we saw last year in the third quarter when we had other vendor transactions in the quarter.

I want to reiterate that our operating margin outlook for consumer, we continue to believe that the one to two percent is the right range to think about for this business in the current fiscal year.

A few weeks ago we showed a mobile device prototype at an event in China. We are working with China Mobile and this effort is consistent with our plans to explore opportunities in small screen devices, as we've discussed.

Just to make sure you have the appropriate context, our primarily focus and our investment priorities remain focused on enterprise and solutions.

On a regional basis, Americas revenue was down 19 percent, EMEA was down 33 percent and APJ was down 21 percent. Our total revenue from BRIC countries was down 17 percent and made up about 10 percent of our total global revenue.

In BRIC, Brazil and China were better on a sequential basis, while declines in Russia were the most pronounced year over year. Revenue outside the U.S. was 45 percent of our total mix in the quarter.

Moving briefly to product highlights. In the client space, mobility units were down one percent and revenue was down 21 percent due to the soft demand in commercial segments and average selling price declines in consumer and SMB. Desktop units were down 23 percent with revenue declining 33 percent.

For enterprise products and services, our server revenue was down 19 percent on a 23 percent decline in units. While sequentially, revenue in units were up nine and 12 percent respectively.

Our worldwide X86 server share was up both year over year and sequentially by 60 and 200 basis points sequentially as we remain in the number two position worldwide and number one in the U.S.

Storage revenue was down 20 percent. Our EqualLogic revenue was up 42 percent with continued strength in margin performance. During the quarter we launched our new PS4000 virtualized storage array with performance and capacity for branch office and smaller SAN deployments.

Enhanced services revenue declined 11 percent to $1.2 billion while our deferred revenue balance grew two percent to 5.8 billion in the quarter.

Although we continue to move toward more stand alone services, a significant portion of our portfolio is made up of support services, which tend to correlate with hardware unit growth, causing the year over year decline.

Software and peripherals revenue declined 15 percent in the quarter, driven by overall client unit declines, as well as softness in displays and imaging.

Turing to the outlook, just of what we said at the July Analysts Meeting continues to hold true. From a priority standpoint we'll prioritize those initiatives and opportunities that drive a balance of liquidity, profitability, and growth. We have a strong bias towards delivering cash returns. Our disciplined execution on working capital and our ongoing cost initiatives will continue to fuel our results here.

The second quarter saw better demand sequentially, particularly in the U.S. and parts of Asia where we are seeing some signs of stabilization, albeit at lower levels of demand.

We do believe it's too early to say we've hit an inflection point, particularly given our mix of commercial accounts in large enterprise and SMB where we continue to see significant year over year demand declines.

For our third quarter we expect to see some seasonal demand improvements from our federal government to consumer businesses, but it's also important to note that the first part of the third quarter is generally a period of slower demand for our large commercial customers in the U.S. and Europe.

From a trending standpoint, we do expect overall revenue for the second half of the fiscal year to be stronger than the first half, assuming that the current demand trends continue.

We believe that a refresh cycle in commercial accounts will be a calendar 2010 story. We remain confident that the significant majority f commercial customers are deferring purchases and will accelerate IT spending to take advantage of technology driven productivity improvements. This acceleration remains predicated on an improving economy and related improvements in customer profits and government tax receipts. While pleased with our gross margin performance, and the ability to offset component and pricing pressures we saw in the second quarter, we continue to see headwinds in component costs, where we have line of sight to increases in panels and memory in the current quarter.

Finally, we also expect to continue to absorb organization effectiveness expenses this year as we continue to realign our business and improve out competitiveness.

With that, I'll turn it over to Michael.

Michael Dell: Thank you, Brian. We're pleased with our progress in an uneven demand environment globally. We also want to reiterate our commitment to optimizing operating income and cash flow growth over time.

The first half of this year saw our revenues down 23 percent, but up sequentially in the second quarter with order rates improving in July and that's extended into August. We've had particular strength in our enterprise products and services with our ecologic storage and our 11G server platform.

Excluding $272 million in OE expense, we delivered first half EPS of 52 cents. Cash flow from operations was 1.8 billion and we built a solid cash position.

Our results demonstrate the power of separating our commercial businesses. Our public business, for example, had strong sequential growth in almost every product group and customer vertical.

Now when we look ahead we see a pretty powerful new product cycle. When you think about the new Nehalem processor family from Intel, Windows 7 to replace, effectively in many customers Windows XP, which is soon to be an eight year old operating system, Office 2010 which comes in the first half of next year, which we think is a very significant addition to the client portfolio and tremendous progress in both client and server virtualization, all these add up to what we see is a powerful new product cycle going into calendar 2010.

And from our EqualLogic offering to our 11G racks and blades to our data center solutions, we are well positioned to integrate and deliver the best value for enterprise customers.

As we explained in July, at our analyst meeting, the large majority of the current and future data center and server and storage opportunities are going to be based on simpler, more open solutions, the very kind that Dell can provide. With our position, our installed base, our tremendous access to customers of all sizes and our growing capabilities, this is where we're focused, where we're winning, and were we expect to continue to win.

Continued progress on our $4 billion cost reduction program and progress on expanding our business across the globe and ongoing investments in enterprise products and solutions taken together, we believe we can deliver a solid operating income and cash flow growth over time.

So now, let me open it up for questions.

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.

One moment please for the first question.

Our first question comes from the line of Ben Reitzes with Barclays Capital.

Benjamin Reitzes: Thanks. Appreciate it. Wanted to ask what happened since the analyst day on gross margins? It sounded like there were going to be in the mid 17s and excluding the gain, around 18.2, so 70 basis points or so of better than expected progress toward the end of the quarter. I was just wondering if you could talk about what happened and the sustainability of things that surprised you there.

Brian Gladden: Yes, Ben, first thing I'd say is you know we're committed to transparency. We, at the time, saw pretty clear pressure after about eight weeks into the quarter. We talked about component costs, we talked about what we're seeing in pricing. We had already at that point, when we talked to you, initiated actions to try and offset that, and we said that during the meeting. And I would just say we're pleased with the execution of the teams. We worked on tighter pricing. We accelerated some of our COGS actions, we managed discretionary costs, we worked through managing the mix, those are some nice accomplishments to get gross margins back where they should be.

Going forward, I would just say, as I said in the comments, we still see some challenges around component costs and I think pricing is going to continue to be challenging and we're working hard to offset those and improve profitability. As we've said, we've managed gross margins within a range. There are clearly some things that we are going to do over time to try and get gross margins up as we invest in the enterprise and the solutions that Michael talked about. That may cause us to invest in OpEx and change the dynamics a bit, but for the short term, we're focused on trying to maintain gross margins.

Benjamin Reitzes: So to be clear, was accelerating your cost savings and managing the mix at the end of the quarter, and was there anything in services, or are those the main things?

Michael Dell: If you look inside the business, what you saw was real strength in the enterprise portfolio and high margin elements of it. And that was a significant contributor to the margins in the quarter.

Brian Gladden: Yes, the mix in the last months of the quarter was significantly better.

Michael Dell: And what we're also seeing as we start to win more enterprise business, it is typically an industry more last month in nature and we certainly saw a fair bit of that in July.

Robert Williams: Thanks, Ben.

Benjamin Reitzes: Thanks a lot, appreciate it.

Operator: We'll take our next question from Brian Alexander with Raymond James.

Brian Alexander: Yes, just in terms of the upgrade cycle comments, I'm just curious why you think PCs will be a huge priority for CIOs next year given we're coming out of a period where spending on almost every technology has been deferred and there are arguably more important investments for companies to make.

And then, just following on, how strong do you think that refresh opportunity will be in the commercial sector, specifically what percentage of the PC installed base do you think will turn over next year and into 2011 for the industry, thanks.

Michael Dell: I think the data center virtualization is going to continue to be a high priority. What I would tell you is that when you look at the age of the installed base, we know that after a certain period of time the cost just becomes pretty onerous and the percentage of these machines out there that are based on Windows XP, which again is an eight year old operating system in another month or two. What many of you may not have done, and I would encourage you to do, is go to Dell.com, buy a modern PC, put Windows 7 on it, put Office 2010 on it, you will love your PC again. And as more and more people do that, I'm here to tell you, there's going to be a refresh cycle next year. It's not all going to come in the first month or the second month, but over the course of the year, there will be a big refresh cycle.

Brian Alexander: Can you be a little bit more specific, Michael, in terms of what percentage of the install base do you think will get turned over next year versus kind of your normal expectation for replacement cycle?

Michael Dell: I don't think we really know. We do know that we have a large install base and we have pervasive customer relationships and certainly we built the product lines to go serve that up. I would also tell you that we're gaining share in servers and storage and building the solution portfolio to win in a data center. So I wouldn't focus only on the client comment.

Robert Williams: Thanks, Brian.

Brian Alexander: Thanks.

Operator: We'll take our next question from Maynard Um with UBS.

Maynard Um: Hi, thanks. Can you just talk about the process for these PC refreshes in 2010? Because it sounds like it's going to be a fairly – so you may get some enterprises kind of refreshing in kind of large orders. Do you anticipate new RFPs that are going to be put out, have you seen any of those RFPs yet, or when do you anticipate those will be there.

And then, just in terms of the competition for those RFPs, should we anticipate that ASPs and margins might be a little bit lower given the increase in competition? Thanks.

Michael Dell: What we've seen so far is that there have been a number of large RFPs and we've actually won quite a few, but they've been delayed in deployment because of the kind of state of the economy and budgets.

We're certainly expecting as the economy is kind of stabilizing, even some signs of improvement that more of those wins that have occurred will start to go to actually being deployed. What the process looks like next year, I don't think we really have any way of knowing at this stage, as Brian said, it will depend on larger economic factors.

But we do know that after a certain period of time, people replace their machines and there's a large install base. The average life has extended and whenever you get an alignment of technology as powerful as this and an old install base, we have every reason to believe that there will be a strong refresh.

Maynard Um: If I could just follow up on that, just on these RFPs that you've won, is there any sense of what percentage of the install bases within those RFPs are being refreshed or upgraded?

Michael Dell: No, don't have any data like that but I can tell you anecdotally that we have customers that have install bases of four and five year old machines and they've planned to deploy new machines, and for budget reasons, haven't done it yet. So we're convinced those will occur, but they're delayed.

Maynard Um: Great. Thank you.

Operator: We'll take our next question from Toni Sacconaghi with Sanford Bernstein.

Toni Sacconaghi: Yes, thank you. I wanted to ask you about operating expense, it was down about 17 percent year over year, revenues were down 22 percent, so I realize it's difficult to keep cutting OpEx at the rate that revenue is falling, but on a sequential basis, it was essentially flat, despite the fact that it seems like you took a lot of organizational effectiveness expense last quarter, I think about 180 billion, and another 73 million this quarter. Is that organization expense not principally workforce reduction? If we work backwards from that math, that would kind of imply 4500 people have come out over the last two quarters yet we saw OpEx actually marginally go up when you make the onetime adjustments sequentially.

So I guess the questions are, one, can you explain what this organizational effectiveness charges are? You've stated that you expect them to continue and accordingly should we expect operating dollars in the second half to be materially lower than they were in the first half of this fiscal year?

Brian Gladden: You mean OpEx in the second half, Toni?

Toni Sacconaghi: Correct.

Brian Gladden: As we look at these organization effectiveness activities, they do span both OpEx and COGS. We have made some changes in our manufacturing footprint as part of the transition and encourage some costs there and that has contributed to our benefits in the COGS line as well. There were also some facilities related costs that show up in those numbers. So that's one perspective around OE.

As you look at OpEx and you look sequentially, there are things that we're investing in. And as we talk about the strategy and gain more confidence in our ability to invest in solutions and building out capability organically, we're doing some of that. You'll see that going forward and as I said, we would hope over time that has an impact as well on gross margins and you see gross margins expand.

So we'll continue to make those tradeoffs. There are costs continuing to come out of OpEx but we are selectively – as we see some stabilization and demand, we are selectively making some OpEx investments in the business as well.

Toni Sacconaghi: If I could just follow up, for the organization effectiveness charges that you took in Q1 and Q2, how much – what percentage benefit did you get? So did you get 50 percent of the benefit from those charges in Q2, did you get 25? I often realize that once you take workforce charges you don't get any benefits for a little while. So what percentage of the roughly $250 million that you spent on operating organizational effectiveness charges have you received benefits from through the end of Q2 and I don't think you answered the question whether you expect OpEx in dollar terms to be lower in the second half or not.

Brian Gladden: In general when we think about these organization effectiveness programs, we tend to look for, in aggregate, a one year payback. And when you get into the details of where these programs and in some cases, when they're in Europe, you have to deal with worker's counsels and you have a bit longer process, your payback isn't nearly that immediate.

So as we look at the second half of the year and some of the actions that we took even in the first part of the year that have involved our European operations, you'll see some of those benefits kick in then. So it varies. But again, in general in aggregate, we're looking for kind of a one year payback on these kinds of programs.

In terms of second half, I think we'll continue to see costs coming out of OpEx. The question is how much are we going to make in organic investments in the business to offset that given our confidence in where we see demand going. So we'll continue to make those tradeoffs. It's hard to say at this point, Toni.

Toni Sacconaghi: Thank you.

Operator: We'll take our next question from David Bailey with Goldman Sachs.

David Bailey: Great, thank you very much. Can you give us a little bit more detail on the improvements that you saw in demand, particularly in July and August either by product area or geography?

Michael Dell: U.S. and Asia, minus Japan, were up sequentially in revenues, 11 percent in Americas and 11 percent in Asia minus Japan. China was up nine percent. The total was three. BRIC was up 16 percent. Emerging and U.S. was quite strong and challenges in EMEA. EMEA was down 13 percent, Japan down 24, although sequentially Japan always has a down second quarter.

And as we talked about the mix into some of the enterprise products was very healthy.

David Bailey: Right but that was for the full quarter. You made a comment that July was, I think, the strongest month of the quarter and that continued into August. Are those areas that continue to be the strength or did you see something different in those?

Michael Dell: Yes, I think the strong areas continue to be strong, U.S. and Asia had strong Julys.

David Bailey: And any comment on back to school so far?

Michael Dell: Back to school looks pretty good.

David Bailey: OK, thank you.

Operator: We'll take our next question from Richard Gardner with Citigroup.

Richard Gardner: OK, thanks. I just wanted to follow up on all the discussion regarding the corporate upgrade cycle next year and ask you, Michael and Brian, whether your confidence in a refresh next year is based on actual conversations that you're having with your customers and what you see in terms of RFP activity, or whether it's more based on just the aging of the installed base that you see out there.

Michael Dell: When we survey our field teams and talk to CIOs out there, this is what we hear. And I think it's not 2010, and it hasn't started yet, and certainly there are risks here. Customers may look at Windows 7 and say well, maybe I'll wait or it has a problem or not good enough. Everything we see right now tells us it's actually quite positive. And we also think there's an overlook of this that most people haven't paid attention to and that's Office 2010. For those of you who are into this sort of thing, you might go check it out.

Richard Gardner: OK. And just as a follow up, I was wondering, Michael, if you have a view on what percentage of the installed base is capable of running windows 7 or Windows Vista at this point, based on your own customer installed base and also, do you – historically, I think a lot of large corporate have upgraded their PC and their operating system infrastructure separately and as long as the PC's you know were good enough for the new OS in many cases, they would put the new OS on the existing hardware base. So I'd be interested to get your thoughts on what percentage of the hardware base is ready for Windows 7.

Michael Dell: It's always a subject of debate in terms of do you put the new OS on the old hardware, I think the difference now is the size of the installed base of old hardware has never been greater. And again, you're talking about a change from an eight year old operating system, so it's a significant change over in terms of the capability and we just see a lot of old machines out there that are going to be replaced. Certainly some people will put Windows 7 on the installed base, generally the larger customers don't like to touch a machine once they put it out there, it's more expensive for them to just leave it in place and do a rolling upgrade.

Robert Williams: Yes and, Rich, I'd just jump in there and remind everyone that we've always believed that this cycle would be predicated on an improvement in the economy and related improvements in customer profits. If you look at the commercial accounts broadly across the globe, you've still got some commercial businesses that are down 20 to 30 percent literally across the globe. That's not just at Dell, that's across many companies that we look at. And people are pretty convinced that budgets are locked for the back half of this year.

Now will it be a little bit better because they didn't spend as much in the first half? Yes, so we're going to continue to remind you guys that we think this is a 2010 event. We're excited about it, but this is something that will begin gradually and build through the year and we'll just have to see how things break in terms of the improvements in underlying economic conditions and corporate profitability.

Richard Gardner: OK, all right. Well, thank you.

Robert Williams: Next question?

Operator: Our next question is from Katy Huberty with Morgan Stanley.

Katy Huberty: Yes, thanks. Good afternoon. Six weeks ago you sounded more concerned about gross margins dropping with the higher competitive cost environment than you do today. Is it fair to extrapolate that it's the strength in server and stored sales that you saw in July and that should continue into the next couple of quarters it gives you more confidence and less volatility on the gross margin line?

Brian Gladden: Well, we've also raised prices and I think we've done some work on COGS. So, it's a combination really of all three that are helping to offset that pressure we see.

Katy Huberty: OK, thanks.

Brian Gladden: Thanks, Katy.

Operator: We'll take the next question from Bill Shope with Credit Suisse.

Bill Shope: OK, yes. I have another question as well on gross margins. Just to be clear, outside of the issues you mentioned, the release and so far in this call, were there any noticeable late quarter improvements in the component pricing environment? Whether through price breaks on traditional components or through volume incentives from Microsoft or Intel that provided a benefits margin after the Analysts Day?

Robert Williams: So, Bill to clarify, you're asking if there were vendor based incentives that benefited gross margins?

Bill Shope: Well, looking at all the components - traditional components including panels, memory and as well as the prices you'd pay through Intel and Microsoft, I'm just wondering – I understand the overall basket was headed in the wrong direction at the Analysts Day, I'm wondering if there was any change in that direction at the tail end of the quarter. Whether one time in nature or whether it's something that you're going to continue to see offset some of the pressure in coming quarters.

Brian Gladden: Bill, nothing surprising. We generally have you a lot of volume-based deals where we have rebates that are tied to specific commitments. But I would tell you in the quarter, the one that deal that we talked about, that we called out relative to consumer business, would be the only thing that I would call out. Everything else was generally typical.

Bill Shope: OK, and then X that vendor buyout, would you characterize the current gross margins as within the sustainable range in the near term?

Brian Gladden: Yes, I think if you take that buyout out, it's probably in the range. Sure.

Bill Shope: OK, great, very helpful. Thank you.

Operator: We'll take our next question from Keith Bachman with Bank of Montreal.

Keith Bachman: Hi, Brian, I wanted to ask you about the services line item, if I could. It was down sequentially – I know it's highly correlated to units, but units were generally up across the board. What conclusions should we draw about the revenue run rate of services as we look out the next couple of quarters?

And related to that, is there anything we should be thinking about in terms of mix that would impact services profitability going out the next couple quarters as well? Thanks.

Brian Gladden: Services revenue as sold was down 11 percent year-over-year, on a sequential basis, pretty close to what we saw with units. The deferred services balance actually grew in the quarter on a sequential basis.

Michael Dell: To its highest ever level.

Brian Gladden: Yes, $5.8 billion. So obviously that's something that we look at in terms of up sell, in terms of attach rates and really a good sign of our progress of building the services business. So that's encouraging for the future and as we continue to build that deferred services balance, that's obviously a positive force going forward.

In terms of mix that we would expect anything different, I don't think so. We continue to grow some of the higher end enhanced as well faster than the core business and that will help, those will be higher margin, but we feel pretty good about the services progress.

Keith Bachman: OK, thank you.

Operator: We'll take our next question from Shannon Cross with Cross Research.

Shannon Cross: Thank you. Wanted to talk a little bit about what's going on in sort of the notebook ASP range. Can you, Michael, talk a little bit about the mix shift that you're seeing to lower ASP notebooks and netbooks. How much of it you attribute to the weak economy versus a more permanent shift down in ASPs. And then if you can talk a little bit about how you're thinking about market share. I know you're balancing profits versus market share, but is there a level of market share that you don't want to slip below and that you'll sort of fight to maintain? Thanks.

Michael Dell: Yes, I think there is, with economic pressure some trading down, we also have seen that customers will get enticed by the price point or the size of a 10-inch or 11-inch platform and then decide that the screen's not big enough and they can't see enough of the things they want to do and they want to go back to a bigger screen.

We're going to be disciplined in managing around operating profit and cash flow here. We're not driving for market share, we're driving for profit.

Shannon Cross: OK, but there's no level that you're sort of watching? You just sort of take it quarter by quarter?

Michael Dell: We're focused on profit share, we're not focused on market share.

Shannon Cross: OK, thanks.

Operator: We'll take our next question from Bill Fearnley with FTN Equity Capital.

Bill Fearnley: Yes, good afternoon, thanks. Michael and Brian, I wanted to ask you guys what's the latest on the up sell part of the direct sales model? How is it working versus your expectations and is it a factor in the gross margins performance this quarter? Any additional color on the attach of additional PC features, service attach, S&P attach, would be helpful in the up sell model.

Michael Dell: Services attach has had a lot of success and you see that in the deferred services balance. Generally attach rates have been good on other items and we continue to build out the portfolio other things. Our ProSupport attach rate has gone from the low 30s to the mid 30s and – actually a little north of the mid 30s. And we built some industry leading features now in to the ProSupport offering, particularly for the enterprise products and that seems to be resonating. We were up mid double digits on blades this quarter, which seems to be pretty different from the industry.

Bill Fearnley: And what about add-ons though to the PCs themselves? You know how are you seeing the customer take on upgrades from memory? Upgrade to hard disc drive size, better graphics? How are you seeing that up sell of those components versus historically? Is it more cash and carry, or how's the up sell working for the components themselves on the custom built PCs?

Michael Dell: We haven't really seen any big changes there. On the enterprise side, memory footprints have expanded considerably as virtualization has become a bigger part of the demand.

Brian Gladden: And our S&P business for the quarter actually performed better than the overall hardware business.

Bill Fearnley: Thanks, guys.

Operator: We'll take our next question from Mark Moskowitz with JPMorgan.

Mark Moskowitz: Thank you, good afternoon. I have a question then a follow up. Just trying to understand more about the sustainability within the public sector. If you could give us a little more color, Brian or Michael, about the drivers there. Is this including China and the stimulus activity over there? Or is it just U.S. federal government?

And then also, was the government piece a big driver of the DSO spike at the end of the quarter?

Brian Gladden: It's typical in the second quarter, we generally have a pretty strong seasonal education driven sector strong growth in the quarter. We enjoyed that quite a bit. That came as expected. I think it's important to understand and put it in the context of an opportunity. We're still pretty focused in terms of the majority of our business is very much a domestic U.S. business. So it's a real opportunity for us to continue to expand that model and do that globally. Most of it was driven by the U.S. and I would say that again, education. It's typically driven - education in Q2 and then the federal budget time frame forces a strong demand in the third quarter and then it drops off in the fourth. So I think in terms of sustainability we would expect pretty strong third quarter and then fourth quarter decline.

Mark Moskowitz: OK, and then just as a follow up, you're doing a nice job in terms of expanding your retail outlet footprint in terms of going to 40,000 versus 30,000 in the prior quarter. Could you guys just comment a little on the quality of the sales you're seeing with these expanded stores? Is this still going to take a little longer before you see a kind of a same store sale improvement?

Michael Dell: It's pretty good. We're in a little over 43,000 retail locations, up a little over 22 percent from the first quarter and we're seeing good traction inside those retail outlets.

Brian Gladden: And for the first time we're getting to the point where internally we're measuring same store sales with these partners, we actually went through the process over the last quarter of changing out some of the poor performers there for the first time. So we've got a robust process to make sure we're getting what we need from these – each of these outlets.

Michael Dell: Particularly strong in China, yes.

Mark Moskowitz: Thank you.

Operator: We'll take our next question from David Wong with Wells Fargo.

David Wong: Thank you very much. Can you give us some feel for the percentage of your notebook sales that are currently netbooks and also what your plants are to introduce CULV machines?

Robert Williams: In terms of netbooks, we'll have to check on that for you, David. It's the penetration in the commercial accounts which is the majority of our business is really not even – it's almost nonexistent . . .

Michael Dell: On consumers, in the teens.

Robert Williams: Yes, it's in the teens in consumers. So then you kind of say well what is that overall? Well, the teens of 25 percent of your units is . . .

Brian Gladden: So that'd be less than five percent.

Robert Williams: Yes, it's a small number.

Michael Dell: Yes, again, we're focused on profit share not unit share. If we wanted unit share we'd go sell a whole bunch of netbooks. But we wouldn't have the operating income we have.

David Wong: Right. On CULV, do you plan to roll out CULV machines in the second half of this year?

Michael Dell: We've already introduced our first CULV, in fact we were first to market with the Inspiron 11Z, go check it out.

David Wong: Right. Thank you.

Operator: We'll take our next question from Jayson Noland with Robert Baird.

Jayson Noland: Sure, thank you. My question on client virtualization, you mentioned earlier in the prepared remarks, maybe if you could talk about your expectations around timing of PC virtualization and then the likely financial impact.

Michael Dell: We've had a great practice around server virtualization and some activity around client virtualization has started. It got a little bit slowed down with the economic issues and there are certain kinds of applications and environments where client virtualization works really well, but it's not every customer in every environment. The offerings are coming together and in line with this refresh and all of the new technology elements, there'll be some good opportunities there, but I wouldn't view client virtualization as pervasive yet as the idea of server virtualization.

Jayson Noland: That makes sense. And is it less attractive from a financial standpoint even if it's just more tactical.

Michael Dell: Well, the way we've structured this is we intend to earn more when we virtualize the client than when we don't virtualize the client, and of course that's all about offering the whole solution for us, the solution stack kind of starts with the storage and server and then goes to the device. The device is the least important part of the profit picture.

Jayson Noland: Understood. Thanks.

Operator: We'll take our next question from Chris Whitmore with Deutsche Bank.

Chris Whitmore: Hi, thanks very much. Had one more gross margin question. First can you confirm that you expect gross margins to be about flat sequentially in the low 18s and what's the component price assumption to get you there in terms of specific components? Can you provide some color?

Brian Gladden: Yes, I'm not going to give you any specific guidance around gross margin rates. I think what I said is we've been pretty effective, even over a period of multiple years of managing within a range and I think you can look at that range and we'll be within that. I think that's what we would say.

The dynamics we see around component pricing, we've called out LCD and memory as the key problem areas. Everything else would be more around typical sort of deflationary trends. So we expect, as I said, to see continued pressure on those two key components in the third quarter and probably get a little bit better into the fourth.

Chris Whitmore: A follow up question on the storage business, EqualLogic continues to go quite nicely, that implies the EMC business is declining materially. Can you comment on the health of that relationship and the health of that product line?

Michael Dell: The Dell EMC partnership is still an important part of our business and we continue to build and work that relationship. The EqualLogic platform is a big one for us, certainly we're attracted by having our own IP and the profit that that brings. But these products are somewhat different. When a customer is a fiber channel customer we tend to focus them on the EMC platform. And obviously EqualLogic is an ISCSI platform today. We're investing further to extend that into broader areas.

I think you can expect to see Dell EMC continue for quite some time and we're working with them on how to create the kind of products that we need that fit with our enterprise offering, because they've got a solid position and we've built a great alliance together.

Robert Williams: Next question, please?

Operator: We'll take our next question from Rich Kugele with Needham & Company.

Rich Kugele: Thank you. Good afternoon. Since you brought up your mobile solution in China, I just wanted to follow up on that. In particular, what it is that the (EC) is attractive to that market and what can Dell bring to the table and if it winds up being solely an Asian solution for you or if you think you can broaden it to other regions. And then, within that context, obviously your Cupertino competitor is talking about a tablet again. That market has never really taken off, it's always been a relatively small percentage of total units and so if you have any perspective on whether you think the tablet market is worth materially chasing or not?

Michael Dell: The way I think about this is first of all, our primary focus is on the enterprise and server and storage and solutions area that we've talked about.

Within our consumer business, we have a carrier centric strategy where we work with the major carriers around the world and you've probably seen commercials and relationships with companies like AT&T, Verizon, Vodafone, China Mobile, et cetera. And within that carrier strategy, we'll go and build products that those great carrier partners want to see and the prototype demonstration that was referred to earlier is one of those products.

Rich Kugele: OK, any thoughts on the tablet then in that sense?

Michael Dell: No thanks.

Rich Kugele: OK, thank you.

Operator: We'll take our final question from Rob Cihra with Caris & Company.

Rob Cihra: Hi, great. Thanks very much. Just had a question on your consumer margins, I guess the X out items. Looks like consumer operating margin was still just over one percent, which is better. Are you still targeting sort of a one to two percent operating margin in consumer and more specifically, assuming that your consumer direct is certainly over that, what does that really mean for your retail margins, either now or and kind of as a target? Is that something that you're almost targeting as just over break even or is it that retail can be two percent and consumer direct maybe even more than that? Thanks.

Brian Gladden: Rob, it depends on the time frame. As we talk about the consumer business this year, we think given the investments they're making in growing the business and gaining share, one to two percent is what we've talked about, pretty consistently with the messaging we've had all year.

Overtime, as we not only grow that direct business, which is a very profitable business for us, but improve the margins in the retail business, we think it can be better than one to two percent, and significantly better than that. So, we've got a plan, we're working through that plan and I think we're on track towards the kind of profitability we would expect from that business.

Rob Cihra: OK, great. Thank you.

Operator: We'll now turn the call over to Rob Williams for closing remarks.

Robert Williams: Thanks a lot. I hope you heard this afternoon that we continue to work on the core business in what is still a pretty challenging demand environment. Particularly as we roll through the back half of the year with challenge commercial businesses around the globe, but at the same time, there's a big focus on our enterprise products and solutions portfolio and we believe that that will help us drive our operating income and cash flow growth over the longer term, and so thanks for joining us and we look forward to talking to you again soon.

Operator: This concludes this conference call. We appreciate your participation. You may now disconnect.

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