DELL INC.
Q3 FY'10 EARNINGS RELEASE
CONFERENCE CALL
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OPERATOR
Good afternoon and welcome to the Dell Inc. third-quarter fiscal year 2010 earnings conference call. I would like to inform all participants that this call is being recorded at the request of Dell. This broadcast is the copyrighted property of Dell Inc., and any rebroadcast of this information in whole or part without the prior written permission of Dell Inc. is prohibited. As a reminder, Dell is also simulcasting this presentation with slides at www.dell.com/investor. I would like to turn the call over to Rob Williams, Director of Investor Relations. Mr. Williams, you may begin.

ROB WILLIAMS – *Dell Inc., Director of Investor Relations*
Thanks, Casey. With me today are Chairman and CEO, Michael Dell and CFO, Brian Gladden. Brian will review our third-quarter results. Then Michael will follow with his perspective. When we get to Q&A, just a reminder to limit your questions to one with a follow-up. We posted a Web deck on dell.com, and we have also released a vlog with Brian. So I encourage you to review these as there is additional perspective on the quarter provided in those materials.

Our Investor Relations activities for the balance of the fiscal year included the CS First Boston Conference and the Raymond James IT Supply Chain Conference both in December, our Perot integration call, which is scheduled for the morning of December 16 and the JPMorgan Technology and UBS Retail Conferences at CES.

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 our 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 statements contained in our press release and on our website. We assume no obligation to update our forward-looking statements.

With that, I would like to turn it over to Brian.

BRIAN GLADDEN – *Dell Inc., Chief Financial Officer*
Thanks, Rob. We are encouraged by our third-quarter results, especially in our Large Enterprise and SMB businesses where we saw sequential growth for the first time in seven quarters. This is of particular significance for Dell given our higher mix of commercial business relative to the industry and key competitors and the nature of the consumer-led recovery.

We also made solid progress on our key strategic initiatives this quarter. This includes improving the cost structure of the Company through our COGS efforts and continued OpEx control, executing a differentiated enterprise strategy and delivering strong cash flow from operations. Overall we grew sequentially for the second quarter in a row, and we expect the fourth quarter to again be sequentially bigger than the third quarter. We saw improving demand momentum in our Large Enterprise and Small and Medium businesses later in the quarter, and this appears to be carrying over into our fourth quarter.

With that, let's move to the third quarter P&L and the key performance metrics, which you will find on pages six and seven of the posted webdeck. Revenue was up 1% sequentially, while down 15% year-over-year to $12.9 billion. This year-over-year comparison has improved versus our first half year-over-year performance, which was a

23% decline. The commercial business, excluding a seasonally down public business, grew 4% sequentially on improving demand as we said in SMB and Large Enterprise.

Our third-quarter reported revenue was adversely affected by the timing of the Windows 7 launch in our SMB and Consumer businesses where we did build more backlog than normal due to the late quarter order dynamics. We expect our backlog to return to more normal levels in the fourth quarter, assuming we've managed through some of the component shortages, which I will discuss in a moment.

The gross margin for the quarter was 17.3%, OpEx was 12.8%, operating income was 4.5% of revenue, and our EPS was $0.17 on a GAAP basis. Organizational effectiveness expense was $123 million or $0.05 after-tax in the quarter with the majority of this expense related to COGS. The biggest item driving this expense this quarter was the closure of our Winston-Salem, North Carolina manufacturing facility, which was announced earlier in the quarter. $59 million of this expense is non-cash, which represents the majority of the Winston-Salem closure expense. Intangibles amortization was $40 million or $0.01 after tax and primarily again affected COGS.

Adjusting for these items, our gross margin was 18.3%, OpEx was 12.5% of revenue, and our adjusted operating income was $740 million with a relatively strong rate of 5.8%. Frankly, we had some challenges below the operating income line in the P&L. Financing and other expenses were $63 million, driven by the higher interest expense related to the $3.8 billion in debt we are now carrying, lower investment yields on our invested cash and heightened foreign exchange rate volatility, which is reflected in mark-to-market on our currency hedges and in F&O. As we look forward, we expect to incur approximately $50 million per quarter in interest expense going forward, and our investments are currently returning about 30 basis points per year in return.

Our tax rate for the third quarter was 34.5%, which was driven by an increased mix of profits in higher tax jurisdictions and our mixshift to enterprise products and services. Our current view for the full-year tax rate is 28% to 30%, which is the same as our year-to-date rate. When you adjust earnings per share for the organizational effectiveness expense and intangibles amortization, we delivered $0.23 per share in the quarter.

Expenses related to our broad-based performance, broad performance-based long-term compensation plan, which is primarily equity-based, was $78 million, split roughly 15% in COGS and 85% in OpEx.

We had another strong operating cash quarter. Referring to slides eight and nine in the webdeck, we generated $801 million in cash flow from operations, which is significantly in excess of our net income for the quarter. Year-to-date we have generated $2.6 billion in cash flow from ops, and over the past four quarters, we have generated $3.4 billion in operating cash flow, which is up 42% versus the prior four quarters.

Our cash conversion cycle improved again by one day sequentially to negative 36 days. For the quarter receivables decreased two days and inventory increased one day, consistent with the seasonal consumer ramp, especially given the Windows 7 timing. Payables remained flat at 84 days as a result of structural supply-chain improvements and our ongoing transition to contract manufacturing. We continue to target cash flow from operations in excess of net income and a cash conversion cycle that is negative 30 days or better before the impact of the Perot acquisition.

Turning to the balance sheet on slide 10, we ended the quarter with $14 billion in cash and investments, and as a reminder, this balance has already been decreased by $4 billion as of November 3 when we closed the Perot transaction.

Moving to slide 11, we are pleased with our progress in Dell Financial Services. This business is a strategic asset for us and generated $900 million of new originations during the quarter. We saw third-quarter managed basis losses decline from 8.2% to 7.2%, driven by favorable delinquency performance in the first half of the year. We continue to intensely manage credit and take the necessary actions. With respect to our CIT relationship and their recent bankruptcy filing, there has been no impact on DFS, and our CITs' international operations are continuing to be fully operational and able to fund new business as we move forward.

On the COGS line, we continue to make great progress in our overall $4 billion cost savings efforts, and we have accomplished a significant amount of work. We still have more to do. Our product redesign driven cost reductions have progressed to the point where 65% of our business clients and 75% of our consumer platforms have been cost optimized and redesigned as you can see on slide 12. This program will continue as we cycle through our product portfolio and further reduce the total costs of the bill of materials on our key hardware products.

In supply chain 2.0 we are ramping work to optimize our global supply chain in order to effectively serve our different customer fulfillment models. We have improved logistics capabilities in areas such as freight where we have increased the utilization of ocean shipping and are beginning to drive complexity reduction and reducing significant numbers of SKUs with product design simplification activities.

Approximately 43% of our manufacturing volume that was shipped in the quarter has now gone through contract manufacturing partners. We are also seeing improved cycle times across our new manufacturing footprint. As we mentioned during our second-quarter earnings call, we did see pressure in the overall component cost environment during the third quarter, and we expect a number of components to be similarly challenged in the fourth quarter.

Turning to the business units, we had mixed results in the business units, but we did see positive momentum in many places. The business unit results can be found on pages 13 through 16 of the webdeck. Large Enterprise had revenue growth of 4% sequentially and was down 23% year over year to $3.4 billion of revenue. This business is down from a quarterly peak of $4.9 billion in the first quarter of fiscal year '09 and as a result has suffered from deleveraging on the cost side. Operating income as a percentage of revenue was down 10 basis points sequentially to 5.1%, driven by this lack of scale. We saw sequential growth in server revenue, which was up double-digits, along with increases in mobility and services. We remain confident that this segment is well positioned for significantly better operating leverage going forward, and we continue to make critical investments in R&D in areas like EqualLogic and our next generation services as we manage costs tightly.

Public had another great quarter with revenue down 3% sequentially and 7% year over year to $3.7 billion. Seasonal federal strength in the US was a key contributor to revenue, while we saw the typical seasonal decline in our Education business. Operating income percent was up 40 basis points year-over-year to 9.5% as we continue to sell higher valued solutions to our customers in the public space. Like last quarter, this was our best performing business on a year-over-year basis.

Our small and medium business revenue increased 5% sequentially and was down 19% year over year to $3 billion. We saw demand strengthen through the quarter in a number of areas, and the third quarter was our first quarter of sequential growth in seven quarters for SMB. Positive trends in the Americas and Asia continued through the quarter, while EMEA is challenged but picked up in the very end of the quarter. Operating income percent improved 80 basis points sequentially to 9.5% of revenue as we improved mix, then scaling in SMB. Our efforts remained focused on delivering high-value offerings and expanding our relationships through increased coverage. We are especially excited in SMB about our "Take Your Own Path" campaign, which highlights entrepreneurs who use Dell technology and solutions to solve their business problems.

Our Consumer business posted a 17% year-over-year increase in unit volume and revenue of $2.8 billion, down 1% sequentially and 10% from a year ago. While profitability in the quarter was sequentially down, operating income for the year is at 1.2% of revenue, which is consistent with our full-year target between 1% and 2%. Though demand in our direct business moderated in early October in anticipation of the Windows 7 operating system launch, we have seen strong momentum since that launch, which has carried over into the current quarter.

As you know, Dell and Perot services were separate companies at the end of the third quarter, and we closed the acquisition early in our fourth quarter. I did want to touch on a few items from their third-quarter results as you begin to factor these into your model going forward.

For the third quarter Perot Systems revenue was $629 million, which was down 12% while flat sequentially. Gross margins were 19.4%, and operating income was 6.8% of revenue. As a reminder, approximately 72% of Perot's quarterly revenue comes from their backlog. So you should expect to see a similar result in the fourth quarter though they do typically see some seasonal softness in billings in the fourth quarter. Perot also delivered $85 million in cash flow from operations during the quarter. Again, we are pleased to have the Perot team on board, and we will have a lot of additional details to provide on our combined services business and Perot synergy plans update next month on December 16.

On a regional basis, sequential revenue declined in the Americas by 2%, while EMEA and APJ were up 6% and 7% respectively. We saw signs of momentum in the Americas and Asia, while EMEA continues to encounter more challenging macroeconomic conditions. Our total revenue from BRIC countries was up 18% sequentially and made up nearly 12% of our total global revenue. In BRIC, China, India and Russia all demonstrated strong sequential growth, while Brazil was also positive but more moderate. Our total revenue outside the US was 47% of our total business.

Moving quickly to some product highlights, in the client space, mobility units were up 11% sequentially, and revenue was up 8% due to increased demand in all segments, while year over year revenue declined 14%. Average selling prices in mobility declined by 2%. Desktop units were down 10% sequentially with a revenue decline of 9%.

On enterprise products and services, server revenue was up 10% sequentially on a unit increase of 1%, while revenue and units were down 6% and 7% respectively on a year-over-year basis. Our worldwide x86 server share was up year over year by 180 basis points, while down 90 basis points sequentially as we remain in the number two position worldwide and number one in the US.

Storage revenue was down 8% sequentially and 19% year over year. EqualLogic revenue was up 31% with continued strength from a margin standpoint. Our overall storage margin rates are up over 30% versus where they were last year.

Enhanced Services revenue rose 2% sequentially to $1.2 billion, while our deferred revenue balance increased 2% from Q2 to $5.9 billion. This is also up 6% year over year. The dynamics of the service business will change beginning in the fourth quarter as we integrate Perot Systems. With Perot we extend the Dell services business into hosting, consulting, application development and business process outsourcing, and we anticipate expanding our managed and modular services businesses as part of the integration.

Software and peripherals revenue grew 1% sequentially and was down 7% year-over-year. Q3 saw some sequential improvements in revenues in both displays and imaging.

Turning to the outlook, our focus remains unchanged since last quarter at our analyst meeting in July. We remain intent on driving improvements in our core business, making strategic investments in our enterprise assets and using liquidity, profitability and growth as our framework to drive long-term value creation.

We are seeing improvements in the underlying market demand trends on a sequential basis in a number of areas, including a significant portion of our commercial business. These improvements have sustained themselves into the first part of our fourth quarter. With growth returning to our commercial business, we believe we are well positioned to benefit.

For our fourth quarter, we expect to see typical holiday demand improvements in our Consumer business, while businesses such as Public are seasonally lower during the quarter. We are confident that revenue for the fourth quarter will be stronger than the third given the demand trends we are seeing today.

As I mentioned earlier, we anticipate some tightness and component cost pressure, particularly from memory and LCDs. You should also consider our higher mix of lower margin consumer revenue in your seasonality assumptions as we look at our fourth quarter.

We continue to see a significant majority of commercial customers defer purchases, while the average installed base continues to age beyond historical norms. Recent technology introductions, indications of improving overall economic activity, and the prospect of a lift in associated IT spending position the Company well, particularly as commercial customers upgrade their IT assets over the next year.

In order to provide more information to shareholders, we have made the decision to provide additional Regulation G disclosure, which bridges GAAP and non-GAAP information beginning in our fourth quarter. This will allow us to provide investors with a clearer view of items such as acquisitions, intangible amortization, acquisition-related expenses and organizational effectiveness charges.

With that, I will turn it over to Michael for a few comments.

MICHAEL DELL – *Dell Inc., Chairman & CEO*
Thank you, Brian. While we are in the midst of a significant transformation in our business, we remain biased towards expanding profitability and cash flow generation. Overall adjusted operating income without organizational effectiveness and amortization of intangibles was 5.8%. Our Public and Small/Medium businesses operated with 9.5% operating income, and we believe we have opportunities in large enterprise as the growth returns to that business and as we accelerate our enterprise solutions including services.

Free cash flow year-to-date was $2.9 billion and was $3.9 billion over the last four quarters, and we are focused on expanding our returning revenue and profit streams with a differentiated view of how to win in the enterprise. Storage and server revenues were up 5% sequentially as we continue to bring our customers an expanding portfolio of best value enterprise solutions. EqualLogic grew 31% year-over-year with a strong pipeline heading into Q4, including demand for our recently launched PS4000 virtualized storage array. We have now added over 10,000 new customers to the EqualLogic platform, bringing us almost 15,000 customers, and we continue to invest in the R&D, the solutions and the sales resources to expand this platform.

We continue to make progress in the data center. Our Data Center Solutions group achieved record revenue with triple digit growth both sequentially and year-over-year. This brings our total share in the United States for x86 servers to an industry-leading 38% in the most recent quarter.

We are also excited to welcome the Perot team and the platform that this provides with now a combined Dell services business of $8 billion in annual revenue with $13 billion in combined backlog and deferred services revenue. Together the expanded Dell Services supports approximately 30 million computer systems and manages over 2 million seats.

In healthcare we have over 2500 accounts but just 130 overlap. Overall we see significant opportunities to grow horizontally, vertically and by geography, and we will discuss this in much more detail in our call next month.

We also expanded two key partnerships in networking with Juniper and Brocade, and we remain on track with our cost optimization activities and remain committed to target investments in the business to bolster our enterprise capabilities. Our third-quarter OpEx was down nearly $200 million versus the third quarter of the prior year and down over $400 million versus the third quarter of '08 with also very significant progress in COGS.

Now let me turn it over to the operator for questions.

TONI SACCONAGHI – *Sanford Bernstein*
I have one question for Brian and a follow-up for Michael. Brian, you had mentioned that because of Windows 7 that you had experienced a larger than usual backlog in this quarter exiting the quarter. Can you help quantify how material that was and how we should be thinking about potentially making an adjustment for revenue that maybe would have recognized this revenue -- this quarter had it been more normal and not had that Windows 7 bump and ostensibly how much benefit you might have started next quarter because of that?

BRIAN GLADDEN – *Dell*
I think as you know we run the business generally with a pretty minimal backlog. I think what we saw was that order patterns, especially in SMB and Consumer, where order rates were somewhat depressed probably in the two weeks prior to the launch of Windows 7 - so the middle two weeks of October. Once we saw the launch happen, order rates picked up significantly. That contributed to some orders that came in in the last couple of weeks that obviously we just could not get out given the timing.

So I would not call it material enough to impact how you are thinking about the fourth quarter. And again, we do think it's going to be a sequentially improved fourth quarter just based on the order rates we have seen.

TONI SACCONAGHI – *Sanford Bernstein*
And then the follow-up for Michael, please. Michael, you had commented two quarters ago that you expected a powerful PC replacement cycle. Do you still hold that view, and should we be thinking about materially above a normal trend PC unit market growth of 10% for 2010?

MICHAEL DELL – *Dell*
Yes, I would not be surprised to see it well into the teens. I think there is an aging installed base for sure. And you just have an accumulation of new technologies at the hardware, software, virtualized client, and these IT managers really know that they cannot extend the life of these client assets forever. And while I don't think it is all going to occur at once, I think it will be a rolling refresh that occurs over perhaps 18 months. I think a lot of these -- I cannot remember a time when a very high percentage of them skipped an entire operating system. And so what we remind them is that -- and they know this -- Windows XP is eight-years-old. So yes, I think it's going to be a pretty powerful cycle.

BILL SHOPE – *Credit Suisse*
My question is on the potential corporate upgrade cycle as well. Once this cycle begins potentially sometime next year, I suspect other large OEMs will be jockeying for share of the pie as well. In that instance will you still focus on gross margin preservation over market share stability, or does the strategy change somewhat to a more growth-oriented focus?

MICHAEL DELL – *Dell*
Well, we think we are holding or gaining share in the right kind of price points. Our efforts on the cost side should expand our ability to profitably compete in a larger portion of the price points.

What I would also tell you is that the pipeline of client opportunities -- we are already seeing more client activity in the last 30 to 60 days than we have in a long time, and the pipeline for client activity going forward into next year is the strongest it has been in a long time as well. So if I look at our commercial businesses, the second quarter was kind of the bottom. The third quarter was certainly better. October was the best, and November looks even better than October. So the momentum of the turns is good.

BRIAN GLADDEN – *Dell*
I would also say, when you think about the shared dynamics we've faced as we have seen consumer growing much faster than commercial, remember, our business is 80% commercial. So by virtue of that mix, we have seen share losses that, frankly, should reverse themselves when commercial comes back in a refresh cycle. So I think just by nature of our mix you will see our overall share position improved.

MICHAEL DELL – *Dell*
But we will absolutely stay biased toward profit.

BILL SHOPE – *Credit Suisse*
Okay. Fair enough and then one more question. Can you comment on how you think about cash usage as we enter a recovery? Should we expect to see you possibly resume some share repurchase activity, or is your priority still on acquisitions and other investments with the cash?

MICHAEL DELL – *Dell*
I think we will continue to look at that. I think clearly we have been through a cycle where we wanted to protect the liquidity and make sure we had adequate cash for survival and then obviously some strategic activities. We continue to look at that. As we have opportunities in the marketplace for acquisitions, that clearly might be part of the strategy, and we will continue to revisit opportunities with the share repurchase as well.

MAYNARD UM - ***UBS***
A question first on gross margins. McAfee talked about accelerated payments to Dell in their September and December quarters. Can you talk about any benefit from that part or maybe warranty accruals in the quarter?

MICHAEL DELL – ***Dell***
Yes, Maynard, we don't really talk about -- those are competitive discussions, and actually we would rather not talk about that. So I think what you have is pretty much all we are going to talk about.

MAYNARD UM - ***UBS***
But just from an accounting perspective, do vendor payments flow through the COGS line?

BRIAN GLADDEN – ***Dell***
Well, it depends on the structure of the agreement and how we would arrange that transaction.

MAYNARD UM - ***UBS***
Okay. Thanks. And just in terms of the -- in the past I think the street did not strip out the amortization of intangibles from pro forma numbers. And given the way you have broken down the pro forma reconciliation, should we be excluding those, I guess, from our pro forma calculations going forward?

BRIAN GLADDEN – ***Dell***
Well, I think, as we said, we are going to introduce a Regulation G reconciliation next quarter, and when we do that, we will explain really all the details of that. That will be one element of our reconciliation.

RICHARD GARDNER - ***Citigroup***
Brian, just given your comments regarding components I've wanted to get a sense number one of how this will affect gross margins in the fourth quarter if we take mix out of the equation? Do you feel like you have got a pretty good handle on what component prices are going to do in the fourth quarter? How are you approaching pricing decisions now? I know that in the past pricing decisions have been made by the business divisions and sometimes have not necessarily agreed with a corporate view of what component pricing is going to do. If you could also talk about whether component availability will be a significant limiter of upside for you in the fourth quarter if demand continues to come back strongly?

BRIAN GLADDEN – ***Dell***
I think we do have a pretty good grip on where component pricing is going for the quarter and in many cases have negotiated deals that for us provide some level of protection versus where the market is going. I think we are in a reasonable position in terms of availability of components. I do know that the industry will have some shortages, but I think we are maybe in an advantaged position there given some of the negotiations we have done over the last couple of months.

I would also say that I think our pricing process given what we know about components is pretty well integrated, and the linkage between our teams in the field and knowing what our component costs are and what our product costs are is pretty good. So given we know where those prices are going, we are taking actions right now from a price standpoint to try and protect margins.

RICHARD GARDNER - ***Citigroup***
Okay. So the follow-up then is we should really be thinking about mix as being the primary factor on gross margins then going into the fourth quarter?

BRIAN GLADDEN - ***Dell***
I think that is right, Richard. We are going to do everything we can to protect the fundamental profitability, and mix will be what mix will be.

BEN REITZES – ***Barclays Capital***
I have got two questions that I guess were not addressed. First, it is obviously all out there in the press and everything and what is going on with Intel and AMD. And there is the NYAG report about, I guess, $1 billion or so of rebates flowing particularly to you and obviously your competitors benefited. I know you cannot really comment on that, but is there any sort of change that has taken place over the last years and even accelerated into the quarter that hurts gross margins given your dealings with that vendor? Is there something like artificially that it also hurt margins in the quarter or over the last year that we should be thinking about with regard to that particular component? How should we be thinking about it? Because we all are. We all saw the numbers, and it's the elephant in the room. That is my first question.

MICHAEL DELL – ***Dell***
Yes, we generally don't comment on these kinds of legal litigation activities. I mean this is a case where we are not even involved in the litigation. So it would be difficult to comment in a lot of detail.

I would tell you that to answer to your question around modeling and thinking about the financials, no change in the way we think about our component costing related to processors. The issues that have been raised in these various legal proceedings about Dell and other systems manufacturers and the rebates for purchases, I think they miss a very important point. And that point is it's really about the net cost of the components, not the rebate. It is really just the net cost that matters. And, as you know, we do everything we can to negotiate lowest net costs and the best value for our customers. Obviously this is a very competitive industry, and it demands that. So that is really our perspective on the issue, and we are not going to comment any further on it.

BEN REITZES – ***Barclays Capital***
Yes, I guess it could just change to lower pricing over time. Anyway. The other thing I was going to ask you is tax rate. It was higher than expected and you said due to mix. But you also have a Malaysian facility that had a very favorable tax structure. I was wondering if the mixshift towards more contract manufacturing was also impacting the tax rate and making it higher over the long term? As the mix maybe moves away from that Malaysian facility, maybe you pay higher taxes elsewhere. If you could explain that effect on your tax rate, that would be great.

BRIAN GLADDEN - ***Dell***
Without getting into a lot of detailed tax planning dialogue, I mean there is no necessarily differentiated tax rate between contract manufacturers and some of our facilities, and a lot of it has to do with where the goods and products are ultimately sold. So it's really a mix of geographic and product line mix changes that drive the tax rate changes.

KATIE HUBERTY – ***Morgan Stanley***
On Windows 7 there has been a relatively clear expectation that the consumer demand uptick is relatively near-term and that the enterprise uptick will come sometime later next year. But I find your comments around commercial as interesting in terms of the strength you saw in October. Do you think that SMBs will act more like consumers and upgrade in the next couple of quarters, or do you think they will act more like enterprises?

MICHAEL DELL - ***Dell***
Well, the small ones operate more like the consumer. The medium ones operate more like enterprise. If you put it together, SMB is at about 50% of Windows 7 today. And we think they tend to go first. I should say that the

momentum we are seeing in the enterprise customers around client has nothing to do with Windows 7 at this point. We are seeing a pipeline of Windows 7 that is starting to build for enterprise customers really next year.

MARK MOSKOWITZ – *JP Morgan*
Two questions here. In the enterprise accounts where you're seeing improvements right now, can you talk a little bit more about the mix? Are these customers targeting more of your higher-end or your lower-end SKUs, and are they also seeking heavier than usual discounts?

MICHAEL DELL - *Dell*
It is biased towards the enterprise portfolio. So services, solutions, storage, servers are definitely -- a lot of virtualization type projects -- are going on. A lot of mission-critical activity going on in those accounts. But we are starting to see more client activity than we have in quite some time. There is definitely a bias in all of these accounts toward value, and they are looking for Dell to bring best value solutions.

MARK MOSKOWITZ – *JP Morgan*
And then in PCs, you talked earlier, Brian, about expecting the consumer to be exhibiting the typical holiday season patterns. I was just curious if there is anything on the part of Dell or your PC peers in terms of a concerted push to try to emphasize notebooks over netbooks this holiday season in terms of driving an improved mix with respect to ASPs? Is there any type of phenomenon taking place?

BRIAN GLADDEN - *Dell*
Well, I can tell you from our standpoint as we look at retail opportunities, we are prioritizing opportunities where margins are best, and we would walk away from deals where margin is not so good. And netbooks actually tend to be one of the areas that is most challenged giving the pricing dynamic right now. So that would tell you that we are trying to prioritize higher-end products with better profit.

MICHAEL DELL - *Dell*
And you can see, our average selling prices are in some cases more than twice that of some of our competitors.

DAVID BAILEY – *Goldman Sachs*
The non-EqualLogic storage sales were weak this quarter. What are you doing to reverse this trend, and how long do you think it will take?

BRIAN GLADDEN - *Dell*
There is a shift going on there where we are moving away from non-Dell branded storage offerings. You can think of this as lower margin pass-through revenue. So our margin on storage continues to increase, and with those additional better mix of sales also come service annuities, which obviously are valuable over time to us. So we are moving more and more of the portfolio to Dell IP, Dell branded and in some cases cobranded products. But that is the direction. That is why you see the shift in the mix and the increased margins.

DAVID BAILEY – *Goldman Sachs*
And then you said you are starting to see more client activity in the commercial space. Is that RFPs, or are you actually starting to ship some PCs into them, and if it is RFPs, when do you think that will start to kick in?

MICHAEL DELL - ***Dell***
No, we are seeing orders and shipments increase pretty substantially in the last -- in the last 30 to 60 days in those enterprise customers, and the pipeline is also increasing.

KEITH BACHMAN – ***Bank of Montreal***
I have two. Brian, for you, first. OpEx, you have taken several hundred million dollars in charges in the April, July and now the October quarter. And if we net out some of the charges, it looks like OpEx has been about flattish over the three quarters. Can you give any color on what are the OpEx trends that we should be thinking about near-term?

BRIAN GLADDEN – ***Dell***
Yes, I think, as you know, we took out an awful lot coming into the year, and that continued through the first quarter. We have continued to, as you know, incur some organizational effectiveness charges to further reduce OpEx, but a lot of that has moved to COGS during the course of this year as we've addressed some of the manufacturing footprint.

I think what you see is we are making some selective investments. As I mentioned, as Michael has mentioned, whether that is in R&D around some of our key enterprise products, some of it is around rebuilding sales force capability in certain markets and solutions capability there. Those are things that we will continue to do. So, as we see some revenue growth returning to the business, we think we can -- and again, I think you will also see a mixup phenomenon with our move to enterprise products that ultimately will require more OpEx as we think about the shape of the P&L going forward.

KEITH BACHMAN – ***Bank of Montreal***
Okay. Fair enough. And then my follow-up relates to that, Brian. Is enterprise -- large enterprise is the lower operating margin business as compared to public and small and medium business. Obviously consumer is running at a lower level, but a smaller relevant size of the pie. So as large enterprise ramps, does that end up putting pressure on the operating margin, or do you have some scale there that ramps at the same time? I'm just trying to understand what the mix will do if and when large enterprise ramps.

BRIAN GLADDEN - ***Dell***
Yes, we really think that the large enterprise business will scale, and it has been the hardest hit in terms of volume reductions. So when that business comes back, we expect that the OpEx will slightly -- it will be pretty flat, and we will see some nice improvement in margin rate there.

SCOTT CRAIG – ***Bank of America***
Brian, when you guys talk about seasonal for the next quarter, maybe a bit of a clarification there. If I exclude out the fiscal fourth quarter of '09, the last couple of years before that seasonality was sort of low single digits on the revenue side. But you go back a little farther back from there and you are talking about up typically 5% to 10%. So maybe some clarification around what you guys would think sort of normal seasonal patterns would be, obviously excluding any impact from Perot. And then I have a quick follow-up.

BRIAN GLADDEN - ***Dell***
Yes, I think it is really hard to look at history given, one, the changes in our portfolio. So our consumer mix is going to be bigger than historical. And I think consumer is one of the bigger drivers of the fourth quarter. But you also have very, very different dynamics in the marketplace in terms of people coming back to buy and some of the refresh stuff kicking off and some improvements in demand that we have not seen. But I think it's very hard to tell based on historical demand what you would expect going into the fourth quarter. We do as we said think it is going to be sequentially bigger.

SCOTT CRAIG – *Bank of America*
Okay. And then with regards to the large enterprise business, it was -- I know this was just one quarter -- but it was up quarter-over-quarter from a revenue standpoint, but operating margin actually declined a little bit. So it did not appear to be scale there. Can you maybe talk about the dynamics of what happened there from an operating margin perspective quarter to quarter?

BRIAN GLADDEN - *Dell*
I think it is hard to pull out one quarter and break that apart. Some of it is mix of the business, some of it is the timing of services as we get that on the balance sheet and some of that comes off. I don't have specific details on what the margin change would have been.

MICHAEL DELL - *Dell*
Scott, I think there's a couple of things that they are trying to accomplish in this environment, and that is to continue to make investments in some of their enterprise solutions. A big piece of the EqualLogic investment and the investment in next-generation platforms is borne by the large enterprise group. As you know, they are very focused on making investments in their services portfolio and their enterprise solutions portfolio. So they are really committed to biting the bullet here and committed to those investments that they believe are going to pay off as the growth comes back. I will remind you that business was on a peak at about $5 billion quarterly rate and is down significantly to the current levels.

So it's just now starting to come back. I mean what we are seeing is the beginnings of some improvement in demand in these commercial accounts and the first time in a number of quarters that we have seen sequential growth. So, as that sequential growth gradually comes back and hopefully it builds maybe through the middle of next year and into the back half of next year, that is when some of the operating margin leverage begins to kick in those businesses.

BRIAN GLADDEN - *Dell*
Our operating income rates were 10 basis points quarter on quarter down. So it was pretty flat with gross margin rates up year over year and flat quarter on quarter. So I think it will scale as we get some volume back.

CHRIS WHITMORE – *Deutsche Bank*
I wanted to follow up on that last point. Do you have a target margin we should think about for the commercial business, the enterprise business? Do you think you can take it back somewhere close to where SMB and public currently run?

MICHAEL DELL - *Dell*
I would just go back to the long-term framework that we have given you around operating margins of 7% plus. When we look at all the things we are doing around COGS and operating expenses and shifting of portfolio here, we think that is a good long-term framework to think about, but it will occur with a portfolio of businesses.

CHRIS WHITMORE – *Deutsche Bank*
What is implied in that 7% operating margin target for the enterprise business, and what is the key variable to get you there? Is it pure volume on the existing structure?

MICHAEL DELL - *Dell*
I think it will be a combination of mix and scale and increased services and more solutions focus.

BRIAN GLADDEN - ***Dell***
I think a lot of the things we are doing on costs will ultimately enable some of that growth to help us get the scaling that we need for the improvement in the businesses like LE.

CHRIS WHITMORE – ***Deutsche Bank***
The last question for me is on the M&A strategy. What are the top two or three priorities from a capability standpoint or a technology standpoint that you are interested in?

MICHAEL DELL - ***Dell***
Well, we are pleased with the Perot acquisition and believe that is a great platform for us. I would say most of our focus would be on smaller targets than Perot. So you should not be surprised to see a portfolio of small to midsized acquisitions that we think add capability along the themes that we have talked about in terms of solutions and delivering **--** bringing best IT solutions to our customers.

AMIT DARYANANI – ***RBC Capital Markets***
I just had two quick questions. One, inventory is up by 14% sequentially. I realize we are expecting some uptick in sales next quarter, but I'm wondering, could you just help us, is that some of the backlog you have exiting the quarter, or did you have to build some of the component inventory that you foresee some shortages for?

BRIAN GLADDEN - ***Dell***
I would not say there was anything unusual in inventory other than the fact that we have a traditional seasonal retail staging that happens in the third quarter. So, as you look at being in position to serve the retail channel for the holiday season, that is really what typically happens. We did mention the fact that we have incremental product on the water in terms of ocean shipments, but I would say that was pretty minor at the end of the quarter.

AMIT DARYANANI – ***RBC Capital Markets***
Got it. And then maybe if you could revisit your outsourcing strategy. I think you mentioned [42%] of your units are manufactured by CMs today or ODMs. Is there a target that you could share with us in terms of what you want personal units to be outsourced? And is there a timeframe that you are targeting to get there?

BRIAN GLADDEN - ***Dell***
Well, it has been part of our ongoing discussion around the $4 billion of costs that we have talked about this initiative. I don't think we have shared a specific target for percentage of volume or percentage of units. I think there are still decisions to be made in terms of where we go with that. It will be more than 43% that will increase over time and it will increase over the next 12 to 18 months is really what we are focused on.

STEVEN FOX - ***CLSA***
Just a question on the SMB segment. As you look at the quarter and look forward, I know you have talked about being underpenetrated in that market. How much of the growth and the expectation for growth is being driven by Dell initiatives roughly versus, say, the market recovering? And then within that, how much faster do you think SMB can grow than the large enterprise over the next few quarters?

MICHAEL DELL - ***Dell***
What was the first question, again?

STEVEN FOX - ***CLSA***
Well, just quantitatively if you could talk about the Dell initiatives to penetrate the SMB market better, how much of that delivered during the quarter, and how much are you expecting that to continue in the next couple of quarters? I'm just trying to understand Dell versus the market in SMB.

BRIAN GLADDEN - ***Dell***
Yes, I think for the quarter we maintained their number two share position in SMB with about flat year-over-year share. So I mean we are sort of moving with the market right now. We are trying to focus, as we have said, specifically on some of the more profitable parts of the market, and I think you see that in the margin rates that we see in the SMB business, which are very good. So I think that is sort of how we are thinking about it. There are some places where we will I think be well positioned to take some share in SMB as we move forward with some of the solutions that we do.

MICHAEL DELL - ***Dell***
Yes, mix is occurring in that business, and there is also a bias towards the emerging countries where we saw, for example, in China a 20% sequential growth, and in India, I believe, it was 26% sequential growth. So BRIC countries, revenues grew double digits. On a year-over-year basis, India was 68%. China was 16%. We see a lot of opportunity with new business formation in those countries and our direct access to those customers allowing us to provide a full suite of products and services and solutions.

STEVEN FOX - ***CLSA***
Great. And then just on that second question, are you more optimistic about SMB versus large enterprise if the cycle continues to improve?

MICHAEL DELL - ***Dell***
I think if you look at it from a size of opportunity, they are both quite large opportunities. We have different opportunities across the different businesses, and we are pursuing them independently, and we think they can both deliver nice growth in returns.

JEFF FIDACARO - ***Susquehanna***
If we look at EMEA, can we talk about the strategy there and your outlook, I guess, going forward? It has been a little bit more challenging environment, especially on the PC ASPs. I'm just wondering what is your strategy there?

MICHAEL DELL - ***Dell***
Well, we think it continues to be a great market opportunity for us to grow. We are under penetrated in EMEA. We saw for the first time in a while some quarter-on-quarter strength with the overall region up 7%. Still down year over year. But we have had to take some tough actions in EMEA. That is part of our cost actions to reposition the business there. I think we are through the majority of that, and continuing to focus on our cost position there is something that is important for us. But a very important market and one we will continue to invest in.

JAYSON NOLAND – ***Robert Baird***
Just a question on timing of various hardware categories. It seems like Dell server and storage has seen fairly positive trends the last couple of quarters. Michael, maybe if you could talk about how your customers are thinking about investment in datacenter hardware versus investment in the client.

MICHAEL DELL - ***Dell***
Well, as I said earlier, I think the mission-critical data center activity has been high, and the Nehalem processor brought out the virtualization wave in a big way because it accelerated the number of servers you could virtualize on

one platform. We have been particularly strong with our Blade offering, with our data center system solutions, with our storage offering. We think our 11g combined server and really management solution that goes with that is a fantastic offering that is really resonating with customers, and it is a place where there is a bias for investment inside these accounts.

We have also done particularly well I think in some of the mega-buildouts of the 25 largest Web farms in the world. I think we captured disproportionate share there with the DCS business. In fact, that business, if it were a stand-alone business, would probably be the third largest x86 server provider in the US in the fourth quarter, surpassing another brand with three letters.

JAYSON NOLAND – *Robert Baird*
Thanks for your thoughts.

ROB WILLIAMS - *Dell*
Alright. Well, again, thanks to everyone for joining us. I think you have heard us talk about the beginnings of some sequential improvement in our commercial business and a clear focus on continuing to build out our Enterprise Solutions portfolio. So we look forward to talking to you later this evening and over the course of the next quarter. Thanks.

~ END ~