DELL INC.
Fiscal Year 2011 Third Quarter
Earnings Conference Call
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Operator: Good afternoon and welcome to the Dell Inc. third quarter fiscal year 2011 earnings conference call. I'd 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. 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. Later, we will conduct a question and answer session. If you have a question, simply press star then one on your telephone keypad at any time during the presentation.

I'd like to turn the call over to Rob Williams, Vice President, Investor Relations. Mr. Williams, you may begin.

Rob Williams: Thank you. With me today are Michael Dell, Brian Gladden and Steve Felice, head of Consumer, Small and Medium Business. Brian and Steve will review our third quarter results, then Michael will follow with his comments. We have posted our web deck on dell.com and we've released a vlog on DellShares. I encourage you to review these materials for additional perspective.

In Q4, we will be attending the Credit Suisse Technology Conference on November 30th, the Barclays Capital Conference on December 9th and the Raymond James Conference on December 14th, as well as CES in January.

Next, I'd 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 statement contained in our press release and on our website. We assume no obligation to update our forward-looking statements.

Please note that on today's call, we will be referring to non-GAAP financial measures, including non-GAAP gross margin, operating expenses, operating income, net income and earnings per share. Historical non-GAAP financial measures are reconciled to the most directly comparable GAAP measures in the slide presentation posted on the investor relation's portion of our website at dell.com and in our 8-K filed today. I encourage you to review these documents.

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

Now I'll turn it over to Brian.

Brian Gladden: Thanks, Rob.

I'd like to start by saying that we had a good third quarter with solid revenue and profitability growth and good cash flow. Highlights for the quarter include an improvement in our gross margins, continued expansion in emerging markets and sustained strength in our global commercial customers' demand, as they continue to see value in our products, services and solutions. These accomplishments validate our strategy and demonstrate we're making progress towards our long-term value creation framework. Revenue for the quarter grew 19 percent year over year driven by our enterprise solutions and services business and a strong commercial client refresh. We believe we're making strategic progress in improving our consumer business, but we do still have work to do there and Steve Felice is here today to provide an update on both Consumer and SMB later in the call.

Execution on pricing and cost initiatives and a favorable component environment led to the highest operating income we've seen in nearly five years. The profitability in our commercial businesses was driven by improved product margins in our enterprise solutions and services and client hardware businesses. Let's take a closer look at the third quarter P&L and key performance metrics, which are provided for your reference on pages five and six in the web deck.

Revenue in the third quarter was $15.4 billion, up 19 percent year-over-year. Enterprise solutions and services grew 31 percent to $4.3 billion in revenue. Our client product business grew 18 percent to $8.5 billion driven by commercial client hardware revenues growth of 23 percent. Sequentially, consolidated revenue was down one percent primarily due to a softer than anticipated consumer demand environment. On a GAAP basis, operating income was $1 billion or 6.7 percent of revenue. Earnings per share was 42 cents, which was up 147 percent year over year and up 50 percent sequentially. Interest and other benefited from the receipt of a $72 million merger termination fee.

For the rest of this call, I'll refer to non-GAAP financial measures. Operating income grew 58 percent to $1.17 billion or 7.6 percent of revenue. All of our commercial segments showed improved operating leverage in the quarter. The commercial segments as a whole delivered 10 percent operating income representing a 230 basis point increase from the previous quarter. We delivered 20 percent gross margins driven by better supply chain execution, pricing discipline and broad component cost declines, which affected all of our lines of business from client hardware to services to software and peripherals. As these component cost declines work themselves through the industry supply chain, we do expect the industry-pricing environment to more fully reflect these changes.

We continue to manage operating expenses well, while we're making important strategic investments in the company. Opex of $1.9 billion or 12.4 percent of revenue was up slightly primarily driven by increased expense related to our performance-based compensation. As we told you in June, our variable compensation plans are directly tied to revenue growth, operating income growth and cash flow. Interest and other expenses were $20 million with some favorability from the revaluation of foreign currency denominated assets on the balance sheet. Our tax rate was 23.7 percent. Earnings per share increased 96 percent year-over-year to 45 cents per share. We generated $913 million in cash flow from operations and $866 million in free cash flow. For the trailing

12 months, cash flow from operations was $3.8 billion. This quarter, we purchased a portfolio of financing receivables from CIT, which brings in house the majority of receivables Dell was managing for CIT as part of our previously dissolved joint venture. There are more details on this transaction in the Web deck on page 10.

Our cash conversion cycle was a negative 32 days. While we saw a one day improvement in days of inventory, payables fell by five days driven by our deliberate reduction of inventory levels and the linearity of our supply chain in the quarter, which we think will normalize in the fourth quarter. Days receivable was flat sequentially. We expect our cash conversion cycle to be in the mid negative 30s.

We ended the quarter with $14 billion in cash investments and issued $1.5 billion in new debt. During the quarter, we repurchased shares worth $200 million.

Now let’s look at our lines of business and regional performance, which you can find detailed on pages 11 through 15 of our web deck. We had another strong enterprise solutions quarter, which is at the heart of where we’re driving the strategy. Enterprise solutions and services now represent 33 percent of commercial revenue in our third quarter. Servers and storage grew 20 percent and seven percent respectively. In servers, our new cloud products contributed to our growth, while demand for blades was up 49 percent. In storage, our EqualLogic business grew 66 percent and we continue to work with EMC to optimize this relationship and drive additional profitable storage growth. In our networking business, revenue was up 36 percent in the quarter.

Dell Services revenue grew 55 percent to $1.9 billion, driven by the combination with Perot. The services business is detailed on pages 12 and 13 of our web deck. We’re now a full year in to the integration and ahead of our revenue and cost synergy targets. We’re seeing solid growth in the discretionary project and consulting and attached based transactional services. Transactional and project services grew five percent and 14 percent respectively. Outsourcing was up one percent year-over-year and three percent sequentially. We do have a strong outsourcing sales pipeline, but we continue to experience a longer outsourcing sales cycle that does appear to be an industry wide dynamic.

We continue to believe that the corporate refresh cycle is well underway and client hardware revenues overall were up 18 percent with mobility and desktops up 16 and 21 percent respectively. In commercial, client revenue was up 23 percent while consumer growth was weaker at eight percent. Software and peripherals grew revenues at eight percent driven by strong performance from displays and electronics and peripherals.

Geographically, we saw revenue growth across all regions with APJ up 29 percent and the Americas and EMEA up 18 and 15 percent respectively. Emerging countries continue to be a key driver. BRIC countries grew at 30 percent and now represent 13 percent of our consolidated revenue for the company.

Turning to our segment level performance on pages 16 through 20 in the web deck- in the three commercial segments combined, revenue grew 24 percent to $12.4 billion. Strong demand, pricing execution and a favorable cost environment led to strong double-digit gross margin, dollar growth in every line of business. The commercial segment delivered $1.2 billion in operating income or 10 percent of revenue.

First, let me start with the large enterprise segment. Revenue was up 27 percent to $4.3 billion led by an ongoing hardware refresh among our largest corporate accounts. Client revenue was up 38 percent and server growth was up 16 percent. Operating income as a percentage of revenue improved nearly 300 basis points sequentially driven by product margin improvements in servers, storage, services and client hardware. Operating income was $400 million or 9.2 percent of revenue for the large enterprise business.

Our public business revenue was up 20 percent to $4.4 billion. We continue to see a tougher spending environment in Europe, offset by overall stable demand in the U.S. Server revenue was up 18 percent with client hardware up eight. Our state and local government business in the U.S. represents approximately nine percent of the public business and less than three percent of Dell revenue. This business was up five percent in the third quarter. Overall, public operating income of $451 million or 10.2 percent of revenue was driven by the higher mix of enterprise solutions and services, tight cost controls and the improved component environment.

Now I'll turn it over to Steve Felice to discuss our SMB business and provide some color on the changes that we're making in our consumer business.

Steve Felice: Thanks, Brian.

As Brian has already mentioned, our commercial business really had a good quarter fueled by our transformation to a solutions provider and strong execution in our client business. Our sales teams are executing on selling the value embedded in our offerings, particularly enterprise services and solutions. Our small and medium business had a very strong revenue and profit quarter. Our direct model gives us a unique advantage in the mid market and we have earned a trusted advisor status with our customers. Revenue of $3.7 billion was up 24 percent, the highest level in two years driven by strong demand across all product lines. Servers and client hardware were up 28 percent and 27 percent respectively. Storage was up 24 percent and EqualLogic, which continues to resonate with small and medium business customers, was up 84 percent. We delivered operating income of $391 million or 10.7 percent of revenue.

High growth and improved profitability occurred in every region of the world. We were particularly pleased to see EMEA continue a year of share gains and strong profitability. And while medium businesses led us into the recovery, small businesses are beginning to see signs of strength. Our recently acquired KACE appliance revenues are exceeding forecasts and we're excited about our recent acquisition of Boomi that will allow us to provide an integration cloud to our customers and new cloud offerings in the near future.

Revenue in our consumer business was $3 billion and we delivered break even operating income. We continue to make great progress in matching our supply chain with retail buying seasons, both our direct and retail businesses were profitable offset by investments we chose to make in the business. We have been working all year to position the consumer business for sustained profitable growth. First, we've streamlined our consumer brands to three, Inspiron, XPS and Alienware. In the past few weeks, we announced an exciting new line up of great products including the Inspiron All-in-one, the Inspiron Duo, a unique convertible netbook, and three new XPS notebooks with industry leading sound and video performance. All of this is enabling our strategy of moving back to a mix of higher price band offerings.

Second, our supply chain efforts are progressing well and beginning to deliver some important results. We've cut delivery times by one week, improved product quality, lowered our manufacturing costs and enabled ocean shipping for a significant portion of our volume ahead of the holiday season. We should see positive results from these changes as we move into the fourth quarter. Third, we have been maniacally focused on delivering a superior customer experience, a heritage of Dell. Our progress is excellent with our most recent loyalty scores up significantly to new highs. Finally, we have shifted our merchandising and advertising to emphasize value with a segmented focus on key consumer buying groups. All of this will lead to sustained profitable growth.

Now let me turn it back over to Brian.

Brian Gladden: Thanks, Steve.

Let's turn to our outlook for the fourth quarter. Our year-to-date results are very good, with revenue up 21 percent, gross margins at 18.3 percent, Opex at 12 percent and our operating income improved to 6.3 percent. Given the cost challenges of the first half of the year and the muted demand for the consumer PC business, we feel pretty good about these solid results and the progress we have made towards improving our operating margins consistent with our long-term value creation framework. We continue to aggressively expand our enterprise solutions and services capabilities. Commercial profit margins in this area have improved in each of the last three quarters and this provides strong validation of our strategy here. We also continue to see a broad corporate client refresh. This growth, coupled with an improving cost environment, provide an opportunity to continue to deliver strong results while also making the critical investments to further our strategic initiatives.

In the fourth quarter, we would normally expect some consumer driven seasonal growth heading into the holiday season, somewhat offset by normal U.S. federal business seasonality. While we do expect consumer revenue to be up sequentially, we expect more muted growth in consumer relative to our previous views. As a result, we expect revenue overall to track inline to slightly up with what we saw in the third quarter. As we think about margins moving forward, we believe the improved component pricing will work its way through the industry supply chain. This effect coupled with a seasonal mix shift to consumer client will likely temper our product margins. We're managing Opex in a disciplined way and are comfortable with the level of spending we've had for the business over the last year.

For the fourth quarter, we will continue to make investments in enterprise solutions, services and sales capabilities. We expect interest and other to swing back to approximately a $50 million expense and we continue to see our tax rate in the 25 to 26 percent range. Finally, we expect revenue growth for the fully year to track towards the middle of the 14 to 19 percent growth range we shared with you in June. As you know, our year-to-date operating income growth is approximately 32 percent. Given our strong operating results in the quarter and year-to-date and a continued favorable component environment, we now expect our total year operating income growth to be between 28 and 32 percent. While we don't intend to regularly provide updates to our annual outlook, we're doing so now given the magnitude of the change in the environment and our improved operating income performance.

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

Michael Dell: Thanks, Brian.

I believe the third quarter results are beginning to demonstrate that the strategy we've described to you over the past year is the correct one. We have a differentiated strategy around the Enterprise that is open, capable and affordable and this is resonating very well with our customers. We're pleased with the improvement in operating margins in our commercial business driven by improving execution and an increasing mix of services and data center solutions. Over the past few weeks, I've spent a great deal of time with our customers across the U.S., Asia and Europe. More than ever, CIOs are telling us that investing in IT is a driver of strategic advantage and is necessary to enable efficiencies and savings longer term.

Our data center and solutions portfolio continues to grow, as does our own field and channel partner capability to deliver these around the world. Our customer engagements are evolving from solely being a supplier of IT hardware to a true provider of IT solutions with a deep understanding of customer verticals. This change will take time, but we're making progress and we're well on our way. Fast growing economies, like China, India and Brazil, are an area of strength for us and should continue to grow rapidly for many years to come.

While we're pleased with the performance during the third quarter, we see great opportunity ahead and have multiple engines of profitable growth and remaining improvements in many areas of our business. We believe we're well positioned to profitably grow in the right areas and navigate the opportunities ahead. It's a great time for Dell and I see this quarter's results as a strong indicator of what's to come.

With that, we'll open it up for questions.

Rob Williams: Thanks, Michael. Just a quick reminder to please limit your questions to one with one follow up. Casey, can we have the first question?

Operator: Ladies and gentlemen, we will now begin the question and answer portion of today's call. If you have a question, please press star one on your telephone keypad. You will be announced prior to asking your question. If you would like to withdraw your question, press the pound key. One moment please for the first question.

And our first question will come from Katy Huberty with Morgan Stanley.

Katy Huberty: Thanks. Good afternoon. Nice job on the gross margins this quarter. Just a couple of questions, Brian, for you as follow up on the guidance. The first is when you say that you're happy with the Opex range you've operated in so far this year, are you referring to Opex in dollars or Opex as a percentage of revenue? And then, if we do assume that operating expenses are flat sequentially in the fourth quarter, that implies a high 18 percent gross margin range. Is that the sustainable level going forward? Or do you think it will take a couple of quarters for the component costs to work their way into industry pricing?

Brian Gladden: Yes, Katy thanks. On Opex, it's really a range around a percentage of revenue that we would talk about. So I think you're math really does make some sense. I would say that, as we look at component pricing, we saw what we would call a more normalized commodity deflation environment in the quarter and as we think about how that trends going forward, we'll continue to see a similar environment as we head into the fourth quarter. We will begin to see, I believe, that deflation really works its way through the supply chain and affect pricing over the next couple of quarters. That's the way we think about it.

And as we look at, the way I think about it, Katy, is the year to date performance with revenue up 21 percent and gross margins around 18.3 for the first three quarters of the year is a relatively good sort of framework and I think as we move towards the long term value creation commitments with seven percent operating income, it's good progress towards that.

Katy Huberty: And just to be clear, to follow up on the Opex, typically in a fourth quarter, Opex does rise sort of low to mid single digits sequentially. Would you expect a similar uptick? Or do you think you can hold Opex relatively flat with revenues?

Brian Gladden: Yes, again, we're managing it to within a range based on a percentage of revenue. So we kind of like where it is right now.

Katy Huberty: OK. Got it. Thanks so much.

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

Toni Sacconaghi: Yes. Thank you. Brian, you alluded to the improvement in gross and mainly – and operating margins by default as coming from three sources, supply chain, pricing and component cost declines. I was hoping that you could maybe – given that some of them are quite interrelated, I was hoping that you could define what you mean by each of those and if you had to dimension the 280 basis point improvement in gross margins sequentially, how much might be attributable to each of those factors? And I have a follow up.

Brian Gladden: Yes. Thanks, Toni. I guess I wouldn't get into that because they really are very interrelated as you think about that and as we talked about coming out of the second quarter earnings call, we did say that we expected gross margin improvement and there were some good external dynamics. Component deflation was about what we expected, maybe a little bit better in the quarter and we saw some of that coming out of the second quarter. Again, we think that will continue for at least the next quarter and as we think about supply chain and all the things we've been doing on costs, I think that we saw the benefit of that kind of come through in the quarter. And at the same time, we were also working pricing and pricing discipline as we exited the second quarter and had the favorable carry-over impact of that and got the benefit of that.

But I would also say, Toni, there's the mix and strong performance we see on the enterprise side of the business is a big part of the strategy, is also a good positive dynamic that's affecting it.

Toni Sacconaghi: OK. Well, just to follow up, I mean it looks as though your guidance is implying a fairly material sequential deceleration in gross margins, call it you know 150 basis points plus or minus, assuming Opex is going to be relatively flat. I think that you thought consumer margins, operating margins would be two percent in Q4, so that would be positive. Do you still stand by that? And in light of the fact that consumer looks like it's going to get better on the operating side and hopefully, that means also on the growth side, what is accounting for what appears to be a fairly significant deceleration in Q4? Is it really all the pricing kind of rolling through in the industry? Or is there something else there? It strikes me as being more than one might anticipate.

Brian Gladden: Yes, Toni. I think consumer will continue to make progress. Maybe Steve could talk a little bit about where we see that going, but clearly the mix of consumer in general in the fourth quarter will be a bit higher as we see the sort of typical seasonality even though it's a little weaker demand. It will be a bigger piece of our revenue and therefore margin and I think as we look at the component environment, we expect it to continue to be pretty good. There will be some areas where I think it will bottom out a little bit in maybe LCDs and hard disks as we see those markets play out. And then the third thing, obviously, is pricing sort of works its way through, Toni, we would expect to see a little bit more challenging sort of competitive environment.

Toni Sacconaghi: Yes, I'm struggling because the mix shift is maybe minus 20 basis points sequentially and it sounds like you feel pretty good on components, so you're basically saying the pricing playing through may negatively impact things 100 or 150 basis points sequentially and I'm wondering if you have high conviction in that number or you might be conservative or it's still not entirely intuitive to me.

Brian Gladden: Yes, look, I think those are the dynamics between mix and pricing playing out and the overall consumer piece. I think those are the main elements that are going to drive gross margins as we look into the fourth quarter.

Toni Sacconaghi: Thank you.

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

Richard Gardner: OK. Thanks. Just to follow up on Toni's question, I was hoping that you might be able to give us a little more color on the competitive environment. And specifically, are you seeing less competitive pressure out there right now given a strong demand bid in the marketplace? Is there something on the competitive pricing front that makes you comfortable that margins will hold, you'll be able to keep a little bit of this component favorability for a little longer than you typically might? And then I've got a follow up.

Brian Gladden: Richard, we'll have Steve talk to that one.

Steve Felice: Yes, I'll be happy to talk about that one. You know the first point I think that's important is that we are moving to a more value based pricing methodology and so, you saw some of that this quarter. And while the competition is always tough out there, I think we're doing a better job of segmenting the business, the types of offerings, the customer sets we're going after and we think that that will continue to help us as we've talked about in the past in improving margins over the long term.

On the consumer business, we're certainly seeing competitive juices flowing in different parts of the world, you know emerging countries. China has seen some increased pressure, but again, we're doing a pretty good job of being selective in how we're growing. Our China business was profitable. So I think the competition continues to be strong, but we're doing a better job of picking our fights and knowing where to grow.

Richard Gardner: Can you talk a little bit about pricing specifically for large enterprise and public as well?

Steve Felice: Yes, I can speak to that in general. That's not the area that I manage, but the dynamics there are very similar to what we're seeing in other parts of the world. A lot of our public business is mid market and so those dynamics are similar to mid market in SMB and there's a good case again where the growth is pretty healthy and so if we're selective about where we choose to sell and the solutions we have, we have been able to hold up the margins pretty well and the pricing has not been as big of a battle as it has in the past.

Michael Dell: I also think we are seeing a pretty material shift in the way we are conversing with our customers. So we used to kind of start the conversation around the box and we're moving the conversation much more to solutions. And so, as we get deeper vertical expertise and understanding about customer requirements, that's giving us a much healthier opportunity to drive up the margin stack and you're seeing that certainly in the commercial businesses and we continue to add more and more horizontal and vertical solutions into the mix.

Brian Gladden: And, Rich, I would just say for both LE and Public, and really across the business, we saw strong pricing really in the quarter and I think you have to think about it. With the cost pressure we saw in the first half of the year, we started working that early in the year and continued to drive it through the summer.

Richard Gardner: OK. Well, thank you. And then the follow up was on large enterprise which was actually strong year-over-year, but down sequentially. And I'm just curious as you consider that to be – actually both public and large enterprise were down sequentially. I know you talked about European government, but I'm curious whether you view those two results as normal seasonal. It seems like they're not and whether you would characterize that a cooling in the corporate upgrade cycle or I guess what's the right way to think about the results in those areas sequentially? Thank you.

Michael Dell: I think one of the trends you see across the business is a pruning of the portfolio where we are taking out revenue that has no margin or very little margin associated with it and you see that across many aspects of our different products and geographic segments. So what you saw is that those businesses improved their profitability in absolute dollars and margin percent sequentially while their revenue might have come down.

Brian Gladden: There is some flattening too of seasonality as our Asia businesses and our European businesses grow faster because they typically don't have big upticks in Q3 and they're becoming a bigger portion of our business.

Richard Gardner: OK, alright. Thank you.

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

Brian Alexander: Thanks. Just on the sustainability of the performance this quarter, which was obviously strong and better than everybody expected. If I just take the midpoint of your new operating income guidance for the year and compare it to your old guidance, the delta is basically the upside you just reported in the third quarter. So it basically implies no flow through or upside to Q4 relative to where most models were. So if the component cost environment is more favorable than you expected, if pricing may get more competitive, but it could take a few quarters so that's not really a big impact right now, you're making strides in the supply chain cost structure, Perot is tracking ahead of plan, those are all good things. Why wouldn't your op income guidance be going up by more than the Q3 upside we just saw?

Brian Gladden: Well, look I think the dynamic is that as we expect this component pricing dynamic is going to continue as more normalized, we would expect that to bottom out in a couple of places and as we talked about, I think we are a bit concerned in terms of how that's going to play out in the supply chain and what pricing does for the quarter. We also do see weaker demand in consumer than we expected coming into the quarter. So those are the dynamics that I think dampen the fourth quarter a bit, but again as you said, there are some pretty good external dynamics to drive business in the fourth quarter.

Brian Alexander: Can I just clarify, Brian, on the outlook for Q4? I know you said consumer will be more muted. Are you saying then that the non-consumer business will be up with normal seasonality in Q4?

Brian Gladden: Yes. That's generally our view. We see sort of normal seasonality around the commercial business in the fourth quarter. Yes.

Brian Alexander: OK. Thanks a lot, guys.

Brian Gladden: Yes. Thanks, Brian.

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

Maynard Um: Thanks. You pre-bought inventory heading into the last quarter, so are you pre-buying here? And, then obviously you've worked down that inventory sometime intra-quarter and I'm curious, this next quarter, you should be getting a full quarter of component pricing benefit. So if you look at that decline in the gross margin, it actually implies a bigger drop maybe in pricing from competitors and typically, the industry doesn't cut pricing unless there is some elastic benefit to units and revenues. So I'm just curious if there's just some layer of conservatism there or if there's some other dynamics that are in play there.

Brian Gladden: Well, I would say on the inventory levels, Maynard, we took the inventory out early in the quarter as we saw pricing coming down. So the majority of the benefits and the declines we saw in component costs - most of that fell through within the quarter. We got most of the benefit within the third quarter. You know again, we're trying to reap forward in terms of how the supply chain and how the competitive dynamics will play out around pricing and there's some degree of uncertainty there and that's what we'll watch through the fourth quarter.

Maynard Um: OK. And then can you just clarify what kind of currency benefits or what kind of currency you're assuming in the outlook for next quarter as well? Thanks.

Brian Gladden: Yes, currency for us in the quarter was relatively minor on the top line, as well as in the income statement and, as you know, our hedging approach is designed to mitigate short term volatility and as we head in to the fourth quarter, we've got sort of our typical coverage and we would expect it to be a minimal impact in the fourth quarter as well.

Maynard Um: Great. Thank you.

Operator: We will take our next question from Stephen Fox with CLSA.

Stephen Fox: Thanks. Good afternoon. Two questions; first of all, you've highlighted Perot in a couple of spots, but can you talk a little bit more color around how successful Perot has been for you, especially you mentioned pull through of additional services, but what about on the hardware side? How it's helping so far and what are the opportunities going forward over the next year?

Michael Dell: Yes, I'd say we're seeing some nice opportunities across both of the businesses as we bring them together. The integration has gone well and we're able to provide customers now with a much broader suite of offerings. That's yielding new opportunities that neither organization was able to go access. We still have a big organic build out in front of us around the world in services, so we have roughly one percent share in IT services, so there's a lot of white space for us to go cover there. But very pleased with the integration and year end particularly in the verticals where Perot had strength, we're seeing tremendous success, for example in healthcare and we can grow this a lot more.

Stephen Fox: Great. And then just secondly on the enterprise cycle, you were talking about normal seasonality for the January quarter, but the last two or three quarters have continued to show more momentum in enterprise spending. Are you suggesting it's slowing down into sort of a more normalized rate? Or is it like you said just seasonal and we can expect we could be looking at more attractive growth rates next year?

Michael Dell: I think with what's going on in the global economy, one would take a bit of caution looking into next year. What we see in our business is that the refresh cycle is very much in full bloom and if you look at Windows 7, you look at Exchange 2010 on the server side, we see enormous adoption there, you look at

Office 2010. We continue to see a healthy refresh cycle and the things that we are selling our customers yield very high ROI and we're able to sell a broader range of them at increasing margins. So we're feeling pretty good about the commercial business.

Stephen Fox: Great. Thank you very much.

Operator: We'll take our next question from Ben Reitzes with Barclays Capital.

Ben Reitzes: Just want to go back to gross margins, if I could. Brian, on your slide on consumer, it said there was a $120 million one-time revenue gain in the quarter. I was just wondering what that was and does that mean that the baseline that we should be judging our gross margins is actually like – was actually 80 basis points lower, so 19.2 should be the baseline for how we go sequentially with your outlook. And then I have a follow up.

Brian Gladden: Yes. What we're talking about was a one-time $120 million increase and it was tied to a change in accounting from a sell through to a sell in model. As you accumulate data in a relationship like this, the accounting basically says you move ultimately to a sell in model once you have enough information to do that. So that was the one timer and that would affect the baseline and as we think about the fourth quarter, the consumer business that's one of the things I'll have to kind of manage through.

Ben Reitzes: OK. And then with regard to Perot, you know the services line seemed like a little below expectations and I was just wondering if Perot is – if your services revenues are meeting your expectations and what did Perot specifically do in the quarter?

Brian Gladden: Yes, Ben, as I think we've said, it's become very, very difficult for us to continue to parse out the Perot stand alone business. You know much of that has been integrated and transactions moving through different systems now to the point where it's hard to tell …

Michael Dell: It's no longer a stand-alone business.

Brian Gladden: Yes.

Michael Dell: I think that's a fair way to say it.

Brian Gladden: Yes. And we look at it now and the elements that we talked about in terms of transactional versus outsourcing versus projects and consulting and with the numbers we talked about there, generally, well, especially on the synergy side, that's probably the best place to look at it. We continue to track above our commitments around synergy there for the deal. So …

Ben Reitzes: Revenue or cost synergies? Sorry.

Brian Gladden: Both of them. Both of those two elements.

Ben Reitzes: OK. OK. Thanks, guys.

Brian Gladden: Thanks, Ben.

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

Keith Bachman: Hi. Thank you. Brian, I wanted to see if I could go back to Opex for a second. I understand your comments around the upcoming January quarter, but if you could talk a little bit about how you're thinking about it for the balance of calendar year '11. Is it a percent of revenues such as revenues grow, you'll keep pace with it? And if growth moderates a little bit because as Michael said the global economy, there's some risk there, how should we be thinking about that Opex line and the variability of it as we think about calendar year '11?

Brian Gladden: Yes, Keith, I think as you move towards our long term value creation model and really where we're going, the longer term, we would expect gross margins are going to trend up as a function of the mix of our business moving and at the same time, Opex will move up as we have more investment in R&D and higher end more costly selling costs within that kind of a business model. So we'll obviously give you a little bit more clarity as we get to the end of the fourth quarter and provide an outlook for FY '11. But I think we will continue to make investments around R&D, around solution selling and around the things we've noted as important to our strategy.

Keith Bachman: OK. But then Brian, if I could just follow up on cash flow. I think you mentioned that cash flow anticipate tweaking down the cash cycle. If you could just talk a little bit about how you're thinking about cash flow over the next couple of quarters specifically?

Brian Gladden: Well, I think the good news is the cash P&L is very strong and that was the key driver of the cash in the quarter despite pressure in working capital and account payable. We think the DPO will move back a few days in the positive direction for us as linearity improves and as the inventory changes in the quarter and as we get back sequential revenue growth. And we should see strong continued mid negative 30 kind of cash conversion cycle and therefore, cash flow should be significantly better than net income as we move forward in the next couple of quarters.

Keith Bachman: OK. Thanks, guys.

Operator: We'll take our next question from Aaron Rakers with Stifel Nicolaus.

Aaron Rakers: Yes. Two questions or one and then one follow up. First on the demand front, I think you guys talk in your presentation about server shipment growth of four percent year-over-year what looks to be against a pretty easy comp a year ago. I'm curious, IDC actually estimated about 16, 17 percent growth in server shipments for the calendar third quarter. Could you help us bridge the gap there? Did October slow down or why the differential in your overall growth relative to the market?

Michael Dell: Server revenues were up 19 percent year-over-year. We don't particularly think units are a great way to measure the server business particularly with virtualization. We're more focused on the profit and the revenue with servers not the units.

Aaron Rakers: OK. The follow up then would be is can you characterize the demand environment in the month of October, relevant to what you saw September?

Michael Dell: It's pretty good. I think there are certainly unit driven deals that come and go that we may choose to take or not take. In the quarter, there was certainly some low margin, high unit deals that we chose not to take. I mentioned earlier the kind of pruning of the business and it occurred across many parts of Dell and I think you see it in the rising, operating and gross margins in the business.

Aaron Rakers: OK, thanks.

Operator: We'll take our next question from Mark Moskowitz with J.P. Morgan.

Mark Moskowitz: Yes, thank you. Good afternoon. The question revolves around the storage business, kind of two parts here. One, it just seems that the growth on a relative basis did decelerate. If you could just kind of talk a little about that, what some of the puts and takes were? And then, more broadly speaking, in terms of the recent M&A activity in storage, Michael, could you kind of just weigh in on what your view is, post 3Par? We've also seen the highest one go away here. I mean, what kind of Dell strategy you're going for to keep pace with some of the other technology players …

Michael Dell: If you look at our storage business, we had EqualLogic growing 66 percent. It's now over a 800 million dollar run rate. We continue to invest in that business. You've seen how we have purchased Exanet to add sifts and then FS, filed system capability, Ocarina, to add de-duplication and compression capability. We're going to continue to build out that portfolio. We have a ten year relationship with EMC. That relationship continues to evolve and we believe that we will continue to be working with them as well. So when we look at the growth in the gross margins in our storage business, we're quite pleased. The gross margins in this business have roughly doubled over the course of the last two years so we're very focused on continuing to grow our storage business and for us, the measures of success are profitability and pretty pleased with the progress we're making.

Mark Moskowitz: I just want to get a sense, in terms of the follow up here, as far as the operating margin associated with some of these enterprise solutions. Can you give us a sense, in terms of your U.S. versus non-U.S. exposure? How should we think about – as you roll out and deploy and then you get your greater scale, say in quarter two, quarter three, quarter four after you've deployed it to some of these bigger enterprise solution accounts. Will the operating margin run rate kind of be the same, U.S. versus non-U.S.?

Michael Dell: Operating margin is not dramatically different by geography. Actually, quite close with the U.S. being right about the average and it takes us a few quarters to kind of roll these things out around the world so they have different rates in terms of how fast we can localize the products and that kind of thing. But we're seeing strong adoption. For example, in China, we've had great success with EqualLogic, and, Steve, you might want to talk about that.

Steve Felice: Yeah, EqualLogic more than doubled in China and the margins were very similar to what we're seeing in the U.S. Storage growth and server growth in Europe came at margins very similar so I really see a very tight range of margin performance on our enterprise business globally.

Mark Moskowitz: Thank you.

Operator: We'll take our next question from Brian Marshall with Gleacher & Company.

Brian Marshall: Great, thank you. I'd like to follow up on the storage side. It looks like you grew about seven percent year-over-year and relative to some of the larger competitors, it seems a little bit light and I was wondering if you're doing well in your branded business, are you potentially de-emphasizing some of your partner programs?

Michael Dell: There is no question that the portfolio of the business is shifting somewhat. As we mentioned, the profitability of the business is increasing in a significant way and, again, we are managing our business to grow our operating profits and dollars. Operating margin and gross margin percentages are going up and there will be shifts inside the revenue mix as we index into more profitable solutions.

Brian Marshall: OK and if you look at your net cash balance, it looks to be about the fifth largest in the entire tech space and I was wondering, with regards to your appetite for M&A going forward, if you're not disinclined to pay some of these 10X LTM revenue multiples going forward for some of these hot properties? Thank you.

Brian Gladden: Yeah, as we said, we're going to have a bit of a discipline and we'll be patient in that approach to thinking about M&A but we're also going to make organic investments in the business and as we've done over the last several quarters, we'll continue with a relatively modest buy-back program, as well so pretty disciplined with that approach right now.

Brian Marshall: Great, thank you.

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

Jayson Noland: Great, thank you. A question on the client refresh – Michael, as I think you said, it was in full bloom. How early are we in a refresh? It feels like it's mostly still in front of us. If you could just expand on that.

Michael Dell: Yeah, all the data that we see would suggest that there is still a very large install base of non-Windows 7 PCs that are going to be replaced by Windows 7 PCs and the preferred path is a hardware driven upgrade for most customers. We also see a huge wave of virtualization, Office 2010 and probably it doesn't get talked about as much, but the Exchange 2010 upgrade, we believe, is very, very strong and we're right in the middle of all that with our customers.

Jayson Noland: As a follow up, how does the virtual desktop discussion and tablets in the corporate world play into a client refresh? Does it slow things down at all?

Michael Dell: Well, virtual desktop is an option for many customers and we're working hard to make that a more viable option. We have full next generation client architecture solutions set to go drive that. I would say that virtual client is still in a very nascent stage of adoption and not seeing widespread adoption yet of that but we would be happy to and we have good solutions for it.

As far as the tablet goes, we think there is obviously a lot of interest and excitement around tablets and we're working on a number of new tablet products that we'll be coming out with next year to kind of cover all the opportunity we see in both the commercial and consumer segments for tablets.

Jayson Noland: Thank you. Congratulations on the quarter.

Michael Dell: Thanks.

Operator: We'll take our next question from Abhey Lamba with ISI Group.

Abhey Lamba: Yeah, thank you. Michael, you mentioned about pruning your product portfolio. Can you elaborate on that? How far along are you and how much margin offset can that offer? Also, what type of elemental impact should we expect from that?

Michael Dell: I'm not sure I can quantify that for you except to say that we're very focused on continuing to have a higher mix of our own intellectual property and driving higher value solutions. We have more to do here but we've made some nice progress and our guide is going to be improving our overall profitability. I think there's more opportunity here as we look ahead into next year.

Abhey Lamba: Got you. Thanks and second, based on your historical experience, what type of impact do you think Intel's Sandy Bridge launch will have on pricing? Is that kind of baked into your exaltation and pricing drop as people might look at flushing inventory in the channel?

Michael Dell: Well, because we're 80 percent commercial and 20 percent consumer, we probably first think about it from a commercial standpoint and what I would tell you is I think, for those customers that have not kicked off a refresh cycle, that Sandy Bridge is a great entry point and we're already having those discussions now. We're seeing a lot of customers planning as that being the entry point. I think i will excite the consumer base as well with the integrative graphics performance and some of the new capabilities there. So, we see very nice things in terms of the product cycle.

Abhey Lamba: Thank you.

Operator: We will take our next question from Amit Daryanani from RBC Capital Markets.

Amit Daryanani: Yeah, thanks. Just going back to public, maybe talk about expectations around normal seasonality downtick in Jan. Could you talk more specifically about what you expect to see in public spending in Europe versus the U.S. in the Jan. quarter?

Brian Gladden: Yeah, you know, it's as we said, that it is a bit of a tougher environment for us in EMEA in public. In terms of the scale of our business, we have a much bigger public business in the U.S. and in North America. So despite the fact that it's a bit of a challenging environment in EMEA, the overall impact on our public business won't be that big and we would be obviously much more heavily weighted towards it in the U.S. public sector.

Amit Daryanani: Got it. And then I just want to go back to the gross margin question that everyone had. If you look at the 280 basis point of margin expansion, how much of that do you think is from sustainable drivers, like better pricing or supply chain savings, versus more unsustainable drivers that will go away like commodity deflation flowing to the industry over time?

Brian Gladden: It's a hard question to really parch the individual elements of that. I would just say the benefits and the positive momentum we have on gross margins is really a function of multiple things, including a good component-cost environment and good execution around cost and solid momentum in pricing and if you think about that as the key elements that drive it, those are things that we're focused on and if the environment continues to be good from a component-cost standpoint, you know, it should be a relatively good environment for us to sustain good momentum here.

Amit Daryanani: Fair enough. Thank you.

Operator: We will now take our final question from Chris Whitmore with Deutsch Bank.

Chris Whitmore: Thanks very much. To follow up on that last question, is there a point where you change strategies and turn more aggressive from a market share standpoint, given your gross margin performance just reported?

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

Chris Whitmore: OK, second question: I wanted to come back to the tablets space and the overall smartphone space. Given the management changes there, what should we expect from a strategy standpoint? Should we expect a meaningful strategy change going forward and can you give us any color in terms of operating system strategy for that mobility space? Thanks.

Michael Dell: Yeah, let me address a little bit of the operating system piece and then I'll turn it over to Steve. You know, we are very much in the mobile space working with both Android and Windows Mobile 7 and encouraged with the development of both of those and see those as great opportunities for us. So, Steve, why don't you –

Steve Felice: Yeah, from a marketplace standpoint, we see a lot of potential here and the changes that we announced are really driven to bring this capability into the mainstream of the business so you can sort of think of it as the last year of us learning and doing it in an isolated fashion but now being more bullish about the opportunity. So we want to mainstream the supply chain, the sales capability, the marketing capability and we see tablets having great potential, not just in our consumer business but in our commercial business so all of this is aimed at getting this more to scale in a faster fashion than we originally envisioned.

Rob Williams: Good. Well, thanks, Chris and thanks to everyone for joining us today. We look forward to speaking with each of you soon.

Operator: This concludes today's conference call. We appreciate your participation. You may disconnect at this time.

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