Dell, Inc.

Fiscal Year 2013 First Quarter

Earnings Conference Call

May 22, 2012

OPERATOR: Good afternoon and welcome to the Dell Inc. First Quarter Fiscal Year 2013 Earnings Conference Call. I'd like to inform all participants this call is being recorded at the request of Dell.

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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.

Mr. Williams, you may begin.

ROB WILLIAMS: Thanks, Regina.

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

During the Q4 earnings call, we discussed our initiatives to create a more streamlined and efficient earnings process. Effectively, we're reducing prepared comments, and increasing the content in the web deck. The web deck along with our Dell Shares vLog are posted to our website in advance of the call, and I encourage you to review these for additional perspective.

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

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

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

Now, I will turn it over to Brian.

BRIAN GLADDEN: Thanks, Rob.

While we continue to make strong progress in the transformation of the company, our first quarter results were mixed, and we fell short of our own expectations. There were some areas where our execution was not as expected, and there also are some market dynamics that created some headwinds for us. We want to be clear that we remain committed to our strategy, and we want to acknowledge that our progress will not always be linear.

Our commitment to build a broader set of end-to-end solutions and shift the mix of our business continues to be our top priority, and we're making progress. Our mix of enterprise solutions and services is now 50 percent of our margin, and 31 percent of our revenue. Dell-owned IP storage, which is a key component of our enterprise solutions and an area where we've made significant investment, grew at 24 percent. And we've announced five, and closed three acquisitions here to date, all of which will help drive higher value mix, and more predictable revenue and margin streams going forward.

Specifically, the acquisitions of SonicWALL and Aperture further enhance our portfolio of Dell security and software solutions.

For the quarter, we delivered revenue of $14.4 billion down 4 percent. This was below our outlook. There are a few key causes to the shortfall. Our sales execution was not up to our expectations, and we've made changes to improve this as we head into the second quarter. Additionally, the demand environment was tougher than we'd planned, and I would specifically highlight weaker demand in markets like EMEA and parts of Asia in addition to public markets.

Finally, we're seeing a more challenging competitive environment in a few areas of the business. We'll address these items in more detail in a moment.

I'll refer to non-GAAP financial measures going forward. Our gross margin was 22 percent, up 30 basis points sequentially, while we saw improved enterprise solutions and services margins and mix, and a sequential business shift from consumer to commercial, margins were impacted by a tougher pricing environment in client products.

OPEX was down $183 million sequentially driven by one less week in the first quarter versus the fourth quarter combined with reductions in G&A and sales compensation. Operating income was $1 billion, or 7 percent of revenue. Cash flow from operations was -$138 million, while Q1 is normally a seasonal low for cash flow, the sequential revenue decline coupled with a 14th week in Q4 negatively impacted our accounts payable balance in the quarter. Our trailing 12-month cash flow from operations was $4.9 billion up 17 percent. We allocated $300 million to capital to repurchase 17 million shares of Dell stock, and ended the quarter with $17.2 billion in cash and investments.

Turning to our lines of business, Servers and Networking grew by 2 percent as we saw the typical pause in server purchases ahead of the launch of our next generation servers. Initial demand for the products is tracking ahead of our plans, and the pipeline is strong heading into the second quarter. We're seeing good traction in our networking business as PowerConnect revenue was up 46 percent year over year, and Force10 increased 69 percent sequentially. Dell IP storage was up 24 percent to $423 million, as the Compellent pipeline continues to strengthen, and EqualLogic grew at 14 percent. Total storage declined 8 percent as third party storage now represents less than 5 percent of our storage business.

Our notebook business contracted 10 percent, as we saw a more aggressive competitive environment, particularly in the entry level and emerging markets. We believe some of the tougher competitive environment can be attributed to channel inventory rebuilding following the hard disk issues of the past two quarters. In addition, we're seeing more consumer IT spending diverted to alternative mobile computing devices. These dynamics impacted both our revenue and margins for the quarter.

In the short term, we believe our client business is well positioned on cost, and we'll focus our efforts on growth on higher margin, higher value segments, with a priority on profit over unit share.

The Services business continues to be a highlight. The business grew 4 percent to $2.1 billion driven by 8 percent growth in support and deployment. The Security business was up 31 percent, driven by our SecureWorks acquisition. Operating margins are up as we continue to improve our cost structure, and increase our attach rates of premium support and deployment services.

Revenue for our Software and Peripheral business declined 7 percent for the quarter to $2.4 billion. Consistent with our prior commentary, this continues to be an area where we'll see pruning of the non-strategic elements of the portfolio.

Before I turn it over to Steve, I want to mention that at the beginning of the fiscal year, we realigned customers between business units with the biggest impact in SMB and Consumer. The details behind this change are included in Slide 19 in the web deck, and the tables, and our press release.

Now, I'll turn it over to Steve.

STEVE FELICE: Thanks, Brian.

Before I get into the results by business unit, I want to provide a more detailed view of factors, which impacted Q1 results, as well as some proof points supporting progress in our transformation. We believe these changes will position us for long-term success. Let's start with sales force productivity where execution was below our expectations and impacted our Q1 results. As you all know, we took action last year to accelerate our transformation by hiring sales specialists to focus on our enterprise business solutions. While we've seen progress here, we still have more to do to improve our sales execution.

Exiting the quarter we've made some modifications to our selling model that will improve results going forward. First of all, we've moved sales resources to better optimize coverage within specific customer sets and geographies. In addition to that, we're increasing our focus on integrated solution offerings, rather than over-specializing on specific products and emphasizing a strong focus on our servers, storage, and notebook products. We implemented many of these changes headed into Q2, as we substantially completed the consolidation of our global sales and marketing organizations. We're confident these actions will improve our sales execution as we move through the year.

Now, looking externally, the environment remains challenging. Consumer spending on desktops and notebooks continues to be under pressure and much of the growth in consumer has migrated to entry-level products in emerging markets where we've chosen not to participate. We're also seeing some IT spending prioritized to purchase other mobile devices. This is mostly a consumer dynamic, but there is clearly some impact in areas of commercial, as well. Growth markets were flat, despite growth in China of 9 percent. We navigated these emerging markets more cautiously in Q1 and we're optimizing for profit, given the economic uncertainty.

Now, there are also many positive indicators that our strategy to deliver converged and easy to manage solutions to our customers is gaining traction. Our enterprise solutions and services growth, excluding EMC, was 5 percent and several products are growing at rates faster than the market. We're also seeing a strong response to our next generation servers. The mix of these servers was over 25 percent exiting the quarter. We're seeing strong momentum in many of our acquired technologies, like Compellent, and Force10, where we've added almost 1,000 new customers during the quarter. Our service business continues to show strength and is building a good pipeline and signing new business that should position us well going forward. Our new signings for the trailing 12 months was 1.8 billion, which is up almost 80 percent, and our services backlog was up 9 percent.

Now I'd like to turn to our business unit results. Large enterprise revenue was down 3 percent, driven by developed markets, which declined 6 percent. We see a good pipeline here, but some customers are delaying their IT spending. Public continues to see spending pressure and was down 4 percent. We are starting to see improvements in U.S. federal spending, but our K through 12 and healthcare businesses were lower than expected. SMB revenue was up 4 percent, driven by enterprise service and solution growth of 17 percent. SMB continues to be a solid business for us, given our scalable solutions focus and strong relationships with these customers. The growth was broad, broad-based geographically, as all three regions grew, which was led by APJ up 10 percent. In total for these three commercial businesses we saw gross margins increase sequentially, and overall operating income was at 9.3 percent. The consumer business was our biggest challenge in the quarter, with consumer notebook revenue down 15 percent, as we limited our participation in the profit challenged, entry-level systems.

On the channel front we expanded to over 103,000 channel partners in Q1. These partners are becoming increasingly important as we provide a broader set of converged solutions on a global basis. And finally, we're confident that we are positioning ourselves well for profitable growth and we believe the recent changes we've made in our global, go-to-market proxies, and organization model will position us better for execution in the coming quarters.

Now I'll turn it back over to Brian to discuss the outlook.

BRIAN GLADDEN: Thanks, Steve.

Despite the good progress we're making with our enterprise solutions and services, our overall revenue performance wasn't where it needed to be in the first quarter. As Steve said, we're confident that we have action plans in place to fix our execution and improve our top-line growth as we move through the year. In addition, the investments we've made position us well as we strengthen our execution.

While we believe spending has been delayed in some areas, we have a healthy pipeline of business and expect to gain growth momentum as the year progresses. We do have concerns about the impact of the competitive pricing environment. We'll continue to monitor these dynamics and adjust our tactics to optimize operating income and cash flow for the company, based on how the market plays out.

While we're not off to the start we expected for the year, it's too early in the year to adjust our FY '13 EPS outlook. We intend to provide an update on the total year outlook during our second quarter earnings call in August. For the second quarter we expect revenue to be in line with normal seasonality of a sequential increase of 2 to 4 percent, mostly driven by our public business seasonality.

Before we take questions let me close with a few summary points. We're fully committed to our strategy and will continue to make investments in building end-to-end solutions capability. This is a long-term strategy and will take time. We're making progress and have several areas where our results are strong, proof points that our strategy is working. And we look forward to providing a more detailed, strategic update in our upcoming investor analyst meeting in three weeks.

Now, let me turn it back over to Rob.

ROB WILLIAMS: Thanks, Brian.

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

Regina, can we have the first question.

OPERATOR: Ladies and gentlemen, we will now begin the question and answer portion of today's call. If you have a question, please press star one on your telephone keypad. You will be announced prior to asking your question. If you would like to withdraw your question, press the pound key. One moment please for the first question. We'll take our first question from Chris Whitmore with Deutsche Bank.

CHRIS WHITMORE: Thank you very much. I wanted to ask about the revenue guidance. What gives you confidence in the up 2 to 4 percent sequentially in front of a major operating system release? Wouldn't we expect to see some pause from both consumer and corporate customers ahead of that?

BRIAN GLADDEN: Yes, Chris, I think, look, we're building off of the first quarter run rate. I think to some extent we've seen some of that pause. It's already in the run rate. A lot of the sequential improvement really is driven by the typical public state-local business and educational dynamics. We look at the pipeline there and that looks like it supports that increase.

CHRIS WHITMORE: And just to follow up, I wanted to understand the gross margin pressures and the client business a bit more. It appears margins and clients were flat to down sequentially, despite the alleviation of the HDD issue. And I would imagine the curtailment of the losses last quarter from exiting the handset business. I guess the question here is, what's wrong with your cost structure, why can't you compete in this marketplace and benefit from some of those tailwinds?

BRIAN GLADDEN: I would talk in general about gross margins and say we did see some good progress in the quarter in terms of mix. Enterprise solutions and services is obviously higher margin. Services margins were up in the quarter sequentially. Both of those things were good. HDD issues generally worked through the quarter, and we've gotten supply. So, that's generally behind us. Commodity inflation, deflation was about what we expected. There was slight deflation in the quarter. But, the thing that we would call out was really the notebook pricing dynamics that we saw in the quarter and some mix within notebooks.

So, I'm not going to provide a detailed walk of that in terms of quantifying it. But, that's sort of what we're seeing going on within gross margins.

Steve, do you want to –

STEVE FELICE: One thing I would add that I feel is a little bit different than the last couple of quarters was the competitive dynamics in Asia. That's where we saw a pretty heavy price competitive dynamic and we backed off, and you saw our growth slow down there. We feel like we're in good cost position overall. There are certain price bands where we don't participate as strongly in and those lower priced products moved pretty heavily throughout China and Asia.

We also feel like there was a bit of a channel sell-in that took place, so there was a lot of competing for shelf space that we didn't think was healthy, and so that puts some margin pressure on. So, I think we're going to watch this carefully over the next quarter, but I don't think what we saw in the first quarter is really something that's sustainable at an industry-wide level.

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

BEN REITZES: Hey, thanks a lot. What are these changes you're making in your go to market strategy that could help sales, and could you give us more detail, and when will they kick in, and in what segments? Thanks.

STEVE FELICE: I'll take that. First, let me say that we're trying to move as quickly as possible in this transformation, and in trying to accelerate the transformation, it requires a level of complexity in adding a number of specialists, in figuring out where the right coverage models are, and in figuring out the right solutions that we choose to sell. And so, the changes are refinements. As we put this business together this quarter, we noticed we got out of position in a couple of areas.

One is, and I'm not going to get specific on which customer sets, but we found ourselves lacking coverage in certain customer sets that we normally excel in, and so we are reallocating resources. A lot of that happened in Q1, is going to continue in Q2, probably for the next few quarters, but we got a lot of that underway.

A second change is really simplifying the bundling of solutions. So, I mentioned this in my comments, with all of the new capability we were tending to sell things on a single product basis as opposed to a more bundled solution. It was spreading our resources a bit too thin, and not taking advantage of the true solution capability that we have. So, we've done a better job coming out of the gate this quarter in having smarter bundles that take advantage of the core products we have in servers, storage, and notebooks, but build around them the terrific IP that we've acquired in a number of the acquisitions we've done.

BEN REITZES: Okay. And then my follow-up was with regard to Windows 8 and Romley, it sounds like servers are off to a good start. If you could be more specific, how much is due to the Romley cycle, and what are your expectations for Windows 8, and when does that kick in, too, if we follow the sequential improvement pattern? Thanks.

MICHAEL DELL: Yes, this is Michael. We're seeing, I think, very good initial demand for our 12th generation PowerEdge, and we were first to market with those products, and feel the product line is incredibly strong. We exited the quarter with the 12th generation being a little over 25 percent of the Server business. So, it's off to a strong start. I think the benefits of this generation in terms of 10 gig Ethernet, and all the performance characteristics, and larger memory footprints going into bigger workloads give us lots of opportunity to grow that. We're also seeing strong adoption of our networking architecture with that as well. As Steve mentioned, we're kind of changing the sale here from server to convert sale of server, storage, networking, and kind of software and services that go around that to support it.

Windows 8 obviously we're totally lined up around the launch of Windows 8. We don't see -- corporations are still adopting Windows 7. So, we don't think there will be a massive adoption of Windows 8 by corporations early on. But certainly the addition of capacitive touch capability into Windows 8 we think will be a welcome addition, and we'll have a full complement of products at the time of launch.

BEN REITZES: Thank you.

OPERATOR: We'll take our next question from Katy Huberty with Morgan Stanley.

KATY HUBERTY: Thanks. Good afternoon. Brian, given the high DSOs this quarter does that suggest that the weakness was relatively concentrated in April? And if that's the case, what have you seen in May that gives you confidence that the business will look pretty normal seasonally in the July quarter?

BRIAN GLADDEN: Yes, Katy, I think April was not what we expected. We had kind of come into the quarter and seen a bit of a lull in the first couple months, and we're looking at pipelines that were pretty strong for April that really just didn't materialize, and saw some things specifically pushed. We feel, as we sit here today, the pipelines look pretty good. We talked about that in the comments heading into the second quarter, and that gives us some confidence that we would expect to see the sequential improvement that we would normally expect.

KATY HUBERTY: And then, just a follow-up as it relates to Dell's strategy to react to the competitive pricing environment, can you continue to walk away from that competitively priced business, or at some point do you need to go after the volume to adjust the cost structure that you're sitting with today?

BRIAN GLADDEN: I think it's clearly isolated to a couple markets in a couple places within the business, mostly consumer. Steve can talk a little bit more about it. I think we've been focused on mid-price, higher price kind of products, higher value segments for a while. I think we'll continue to do that. There are parts of the business where that will force us probably to walk away and prune more revenue than we probably thought coming into the year given the dynamics that we're seeing.

STEVE FELICE: You know the price bands of the products that are attractive to us still make up half the market. In some parts of the world they make up two-thirds of the market. And so, there's going to be a time where the compares are going to not include a lot of low-end product that we're not emphasizing. For example, in this past quarter, our XPS line sold very well, it was up 33 percent, but it's still a smaller portion of our total, but it's growing in mix on a regular basis. And so, at some point, we think that line will be the predominant line for us.

We analyze the cost structure all the time. And, like I said earlier, we think we're in good cost position. I remember a few years ago people hitting us with the same thing when Acer was pushing hard, and we said we were going to be disciplined because we didn't think they could sustain what they were doing, and we saw what happened to them. So, we're not going to overreact in one quarter. We'll continue to look at the pricing dynamics and our cost structure, and we'll make sure we're competitive in the areas we want to be competitive.

KATY HUBERTY: Thank you.

OPERATOR: We'll take our next question from Tony Sacconaghi with Sanford Bernstein.

TONI SACCONAGHI: Yes, thank you. If you stand back and just think about what the Client business delivered this quarter, revenue growth was down 6 percent year over year, it was down 10 percent in notebooks. Your margins were materially pressured. And you had to walk away from a bunch of business. That feels like a pretty sobering market, and market situation. I would like you to comment on whether the PC market is evolving in a less attractive way than you had thought one or two years ago, and what you think about is realistically the normalized revenue growth for the market in clients, and what the normalized revenue growth we should think about for Dell? I would presume it would be lower given that you have said that you may want to continue to walk away from parts of the market.

BRIAN GLADDEN: Yes, Toni, I think, to be honest, if you go back a couple of years, the growth in the PC market has clearly been lower than what we would have expected a couple of years ago, and as we talked about on the call, clearly some of that is alternative mobile devices that I would argue is a relatively new dynamic affecting the business over that period of time.

That said, again, as Steve said, there are still opportunities for us to find growth here. We see it as an attractive business that's still generating good margins, very good margins for us, and we think we can continue to do that. There will be some pruning that continues in that business as we focus on higher profit parts of the business.

STEVE FELICE: When talking to the commercial customers, we still don't see in even the mid-term any material change in their strategies other than maybe virtual desktops which the acquisition of Wyse positions us well in that area. But where we play strongly and there's still an indication from the customers that they continue to stay on the course that they're on, and our biz client products are very profitable.

I think we really probably should limit that more on the consumer side where we did see a lot more margin pressure, and a lot more operating income pressure, but the business client product side of the business was very healthy. That's more of a near-term growth issue, and we do see that being more acute than systemic.

BRIAN GLADDEN: And, Toni, I think in terms of framing up a longer-term view of end user computing, I think we'll spend a fair amount of time doing that as we head into the analyst meetings.

TONI SACCONAGHI: And as a follow-up, I was wondering if you could comment on the forces at work on both operating expense and principally components going forward over the next couple of quarters. Clearly in OPEX you're going to be adding some higher gross margin, but higher OPEX businesses in the form of your recent acquisitions. Should we be expecting OPEX to continue to go up, or do you feel you have it in dollar terms, or in percentage of revenue terms, or do you feel you have plans to offset that? And similarly, on the component side, I can't help thinking that if you believe that HDs have largely come into supply balance, and DRAM pricing looks like it's more likely to go up than down, should we be thinking about pressure on your total bomb going forward over the next couple of quarters?

BRIAN GLADDEN: Yes, to talk about OPEX, Toni. I think we've been pretty disciplined in terms of how we're managing that. And if you look at this quarter, in terms of the demand environment and what happened to revenue, we were pretty disciplined in terms of managing through that. We are still shifting dollars and making investments in important parts of the business. R&D spending is up and that will continue. Some of the sales investments we'll probably moderate in this environment, as we make some of these changes. But, I think what I would say is you can count on us to continue to be disciplined in how we manage OPEX, without giving a specific outlook on that.

In terms of component pricing, I think it's a mixed bag. We've expected, as I think we said in the first quarter, or at the end of the fourth quarter, that memory and displays would probably be increasing in the second half of the year. I think we still believe that. Our outlook would have memory increasing in the second quarter and the third quarter and probably coming back down in the fourth and displays similar.

As we've also talked about, hard disks we would expect to start seeing some deflation as we move throughout the year. So, there's not a lot of change in our outlook in terms of component prices. I would tell you in aggregate, it's probably a little more favorable for the year than what we would have expected three months ago, if you put all that together.

TONI SACCONAGHI: Thank you.

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

BRIAN ALEXANDER: Back to the sales execution, what gives you the confidence that this isn't just the market not embracing Dell's solutions versus this being sales execution related? I guess I don't understand how you're lacking coverage in certain areas, given all the hiring you've done. I think it's been thousands of sales specialists. I would think coverage is going up not down. And just trying to get a sense for how confident you are, and how much you think you have your arms around the situation, and again, what pace of improvement are you expecting?

STEVE FELICE: Yes, you know, actually I'm very confident in this question and in our ability to sell solutions, because really what I would say if we look back this past quarter I think where we stumble a little bit on execution was on transactional selling. The solution selling was strong. We probably -- I don't have an exact number, but just looking at what happened during the quarter the number of offers we had that included servers and storage and networking and services was up quite a bit. When I talk about the coverage, I think we over-indexed a little bit on where we put all the specialists. In other words, too many geographies we probably saturated a place and then left some places uncovered, same thing with certain customer sets. So, we're balancing that. We've added quite a bit of capability and we just have refining to do as we roll that out. But, the actual ability to sell solutions is improving as each quarter goes by.

BRIAN ALEXANDER: Okay. And then, Brian, I guess why not reduce the full year EPS outlook, given the disappointing Q1, the tough pricing environment, which could linger and the sales execution changes that sound like they're going to take time to play out. I mean it seems like you need to generate 80 percent of your EPS in the next three quarters, which is higher than what you've done in the past.

BRIAN GLADDEN: Look, I think based on the quarter there's clearly pressure to the total year outlook, for us to get to that outlook it's going to require improved sales execution. It will probably require a bit of market improvement in the second half, but that's what most of the industry forecasts would say right now. We'll need better revenue growth and good discipline around costs and gross margins. But, I think, Brian, we'd like to see the demand environment and our execution as we head through the second quarter before we give an update for the total year.

BRIAN ALEXANDER: Okay. Thanks.

OPERATOR: We'll take our next question from Bill Shope with Goldman Sachs.

BILL SHOPE: Okay, great, thanks. Given the pricing environment you referenced, should we assume that in-market pricing is going to pressure the gross margin profile in the July quarter and I understand you'll give specific targets there, but if you could just help us qualitatively. And related to that, are you seeing any signs of pricing aggression outside of the client business?

BRIAN GLADDEN: Well, when you put the pieces together, Bill, clearly the enterprise solutions and services growing at a faster rate is creating a positive mix dynamic for the company. And I think we would build a view for the rest of the year that assumes that's going to happen and continues to provide some tail wind on gross margins. We think that should generally offset any pricing pressure and how we manage profit in that client business versus units, I think we can do that. So, that's a qualitative view as you think about that.

What was your second question, Bill?

BILL SHOPE: Are you seeing any signs of pricing aggression outside of the client business?

BRIAN GLADDEN: I think most of the pricing pressure we saw was focused in consumer within the client business and specifically in the emerging countries.

BILL SHOPE: Okay. Fair enough. Thank you.

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

SHANNON CROSS: Thank you very much. A question on cash flow, how should we think about both cash flow and cash use here during Fiscal 2013, especially given the weakness this quarter and the acquisitions that you're going to be closing in fiscal second quarter. Just how are you thinking about cash?

BRIAN GLADDEN: I think the cash P&L continues to look good. We had challenges, obviously, with the working capital dynamic in the quarter and coming off the 14th week from the fourth quarter that affected first quarter cash flow. I think we continue to feel we'll have a strong cash flow year. We will continue to commit to the 10 to 30 percent investment in terms of share buyback for the year. And we feel confident that we have cash flow to support the M&A transactions, as well.

SHANNON CROSS: Okay. And then I'm not sure if Michael or Steve wants to take this, but can you talk a little bit about your tablet strategy, given the pressures you're seeing in consumer with regard to tablets. How are you thinking about tablets, any change to sort of your time frame or expectations?

MICHAEL DELL: We're totally lined up with Windows 8. You'll see us introduce tablets, contemporaneous with the Windows 8 launch.

SHANNON CROSS: And that's still on track in terms of timing?

MICHAEL DELL: It's on track for Microsoft's launch, yes.

SHANNON CROSS: Okay. Thank you.

OPERATOR: We'll take our next question from Aaron Rakers, with Stifel Nicolaus

AARON RAKERS: Yes, thanks, guys. Most of my questions have been asked, but looking at the product gross margin line, 19.2 percent from 19.4, I know that we talked about PC gross margin, it being down moderately on a sequential basis. Can you help us understand how we should think about product gross margin in the context of both the PC side of the division, as well as the ongoing mix shift in the enterprise? Do we maintain a mid-30 percent implied gross margin on enterprise is kind of what I'm trying to get at, as well as the implied 15 to 16 percent PC gross margin?

BRIAN GLADDEN: Well, I think it goes back to our overall strategy clearly, Aaron, will drive faster growth in the higher margin enterprise part of the business. There are still areas where we're building scale in some of the acquired assets and you should see gross margins continue to expand there. I think as we move through some of the next generation products here we would also expect some of those enterprise solutions to have higher margins. So, we would expect that. That will ultimately rise as we introduce those products and expand that business and grow it faster.

On the client side, I think to be honest, we feel like we're in a good cost position. And we feel like we're in a place where we can manage that for a profit, and that's how we'll do that. That's how we'll run that part of the business.

AARON RAKERS: And then as a follow-up on the storage side, you basically have now anniversary-ed your acquisition of Compellent. How do we think about that as you've fully, effectively, as well, burnt off the EMC side of the business there? How do we think about the growth in that division as the comps start to get a little bit tougher on a year-over-year basis?

BRIAN GLADDEN: Well, I think they get tougher, but they get easier, too. I mean we had in the quarter a total of less than $25 million of EMC revenue. So, for all intents and purposes I think we've burned through the headwind associated with that for the total storage measurement for all of the storage business. So, we would expect to see continued strong growth, double-digit growth clearly in Compellent and the EqualLogic businesses as we move forward. And over the next couple quarters, I think that will translate into the total storage business growing at double digits.

MICHAEL DELL: Yes, we're seeing a strong pipeline in storage, and feel very good about the product line that we have there.

OPERATOR: We'll take our next question from Brian Marshall with ISI Group.

BRIAN MARSHALL: Great. Thanks. Brian, you know, with respect to the three reasons you cited for the revenue disappointment in the April quarter, I was wondering if you could talk a little bit more in terms of granularity with respect to how much that was associated with kind of walking away from some of that low margin business? With the revenue disappointment, I would assume that if that were a significant portion of it, that we would actually see margins a little bit better than 7 percent on a pro forma operating basis, and then I do have a quick follow-up as well.

BRIAN GLADDEN: Yes, Brian. I think there were really two areas where we would talk about pruning activities in the quarter. Clearly in the software and peripherals business that was down 7 percent in the quarter, you know, as we've said a couple of times, that's probably the biggest area where you'll continue to see us do that. Some of that, to be honest, is as we acquire IP and build our own intellectual property there are parts of that business where we want to sell our own stuff that's going to have much higher margins. There are other parts of the business that will continue to be unattractive in the grand scale of the overall portfolio that we'll continue to shrink.

I think the second one is really in the consumer business, and you think about the overall growth that we saw there, or the lack of growth was really driven by us making conscious decisions not to participate in business. So, I would isolate those two areas in terms of the big impact on revenue.

BRIAN MARSHALL: Okay. And then with respect to the pace of M&A going forward, is it safe to assume that we should expect that to slow down a little bit here? And if so, kind of a similar sized deals going forward? Thank you.

BRIAN GLADDEN: Yes. You know, we're not really going to provide an outlook in terms of M&A activity. You know, as you think about over the last three years we've had a relatively steady pace of activity there, and I think that's clearly one of the elements of our growth strategy will be to continue to do that. But we feel good about the five that we announced in the quarter, and we've closed three of those thus far, we have two more. And we think they're very good and additive to the portfolio.

OPERATOR: We'll take our next question from Kulbinder Garcha with Credit Suisse.

KULBINDER GARCHA: Thank you. I have a question for Brian, really about the second half of the year. I appreciate you're not providing full year guidance anymore, but can you just at a high level, or maybe Michael could speak about half over half drivers? I get the server business. You're seeing a refresh. You guys don't seem too convinced about Windows 8 having a meaningful impact, immediately at least, this fiscal year. Is there an impact of acquisitions that you're counting on? I'm just trying to understand what can really change the second half apart from a better macro and server business to you guys. Many thanks.

BRIAN GLADDEN: You know, look, I think the combined impact of the five acquisitions that we've announced is relatively small. For the total year, it probably contributes on the order of 1 percent growth in revenue. That clearly, assuming we can close the deals, will happen, and contribute. The server business, we should see a pick up as a result of the launch of the next generation products, and would expect to see that moving through the second quarter.

I think other than that, clearly, there's a Windows 8 dynamic, but that's much more of a consumer business impact relatively late in the year. It won't necessarily impact our overall commercial business.

KULBINDER GARCHA: Okay, great. And I guess just one thing on the whole sales force productivity, and everything else that you guys are trying to push through, and maybe a question for Michael, are you thinking that this may be -- I know you have very lean OPEX already, but is there anywhere to actually lower the cost base further, do you think, as you go through this process?

BRIAN GLADDEN: You kind of broke up Kulbinder, any way to do what?

KULBINDER GARCHA: Can you lower the cost base or on the OPEX side going forward during the sales force productivity process you're going through?

BRIAN GLADDEN: I'll take a first crack at that. I think there are parts of cost structure that clearly are variable. In a lower revenue environment, clearly we had variable sales compensation that was impacted in the quarter, and that shows up. I think there are other places where we're clearly going to stick to the strategy and continue to make investments that drive the long-term transformation of the business.

STEVE FELICE: We do see productivity potential on a per sales maker basis that we will leverage throughout the year. So, we believe they under-performed to their capacity this quarter. So, we're not expecting to have to add to get to this revenue growth. We think we can leverage the resources we have if we better utilize them from the points I made earlier.

OPERATOR: We'll take our next question from Mark Moskowitz with JP Morgan.

MARK MOSKOWITZ: Yes, thank you. This question is either for Steve or Michael. The SMB revenue and operating margin held up fairly well relative to the other segments. The question really is, is this a function of Dell maybe having greater early success will your value add solution sales? And, if this is the case, how long will it take to replicate in the larger enterprise business or public?

STEVE FELICE: Well, you've hit it on the head, I believe. I mean if you really look at this, the amount of complexity and change has probably been the least in the SMB space because the sales motion is simpler. Even when you're selling a more sophisticated solution, you're usually dealing with one person no the other end of the selling chain here. So, it's typically a one-to-one relationship, and you bring experts in as required.

As we move into these much larger spaces, it's definitely a longer sales cycle. You're dealing with more constituents. It's a longer process. And I think we're still feeling our way through that. And so, that's why we do have confidence that what we're building here is definitely scalable. We've just got to get refinement in it to make sure we're doing it the right way.

MICHAEL DELL: Yes, and the results clearly point to that. If you look at the Enterprise Solutions and Services in SMB were up 17 percent. It was led by Services, which were up 23 percent in SMB, and we're bolstering the kind of offerings that those customers will latch onto quickly in backup, replication, network, and security with the SonicWALL acquisition. So, we're feeling confident in our ability to expand that part of the business.

MARK MOSKOWITZ: Okay, thank you. And then my follow-up is really just around the large enterprise commentary. Earlier, Brian, in terms of the delayed IT spending that you talked about, or deferrals, can you provide us some more details just on the timing, when does this manifest? Was it just in the month of April, and is it continuing? And what's kind of the breadth? Is it just targeting PCs, or is it servers, networking, security, even outside of your own business, are you hearing about other parts of software being impacted as well?

STEVE FELICE: I can take that one. And the reason we said that was because we did see healthy pipeline building going on throughout the quarter, and then we did see it slip. So, as the quarter went by, yes, in April we thought we would convert a lot more business, but we did see it slip, but we didn't see the pipelines go away. The pipelines remain healthy. And we have lots of anecdotes of customers just saying, you know, they're cautious, they're trying to spread out their budget, and things like that. So, we had enough evidence of that to feel like this is a bit of a pattern going on. The pipeline remains healthy. We are seeing some conversion happen.

So these things aren't going away. And that's why we're trying to be patient here. It did happen across the board. It wasn't just notebooks. As good as our storage business was, we probably could have even done better in storage based on the pipeline that we have. So, I think it's a broad-based budget concerns by customers, and we're watching this on a month-to-month basis.

MICHAEL DELL: Yes, and as we mentioned earlier, we first look to our own execution and we see opportunities to improve there, but we tend to be closer to the action in terms of customer spending. I can tell you my own interactions with larger customers we are seeing kind of delay and pause in spending activity. But the pipelines are healthy, and we're very focused on bringing that business to closure.

MARK MOSKOWITZ: Thank you.

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

KEITH BACHMAN: Hi, I had two questions, please. First, I wanted to get your take on the Windows 8 impact on the consumer business. And the area I was hoping you could address are mix, how you think the mix with say tablets versus ultrabooks will unfold, and then also on consumer behavior, with consumers having to get used to, or acclimated to, the Metro interface and the applications that may or may not be supported, leading to also the potential impact of Windows 8 on margins, if you do have more tablets and/or higher cost touch-screen notebooks, how that might impact your margins. And then I have a follow-up, please, thanks.

MICHAEL DELL: Well, those are great questions. I don't think we have all the answers to those questions. But, what I can tell you is that we think that the touch-screen products will certainly cost more. They're more in the price points and price bands that we tend to operate in. We will have a full complement of products around the time of Windows 8 being announced and available. We think there will be -- unlike other Windows transitions this is a transition where you generally are going to need a new PC, whether it's a tablet, or an ultrabook with touch, or a notebook with touch, or a PC with touch, or some derivative hybrid of all of the above type products. The product refresh cycle associated with this release of Windows is likely to be very different from other releases. But, it's hard to know exactly what that looks like. We're preparing a full complement of products. And we'll be ready with those, as we said earlier, at the time of the Windows 8 release.

KEITH BACHMAN: Okay. Fair enough, then. My follow-up is on the services side. If I look at the breakout, infrastructure, and cloud, and applications and BPO, where add them together roughly flat, and support was still up nicely. How should we be thinking about as unit growth slows here, indeed it has slowed, the combined growth rate of services, as we look out over the next couple of quarters, given what I just mentioned, that two of the buckets look like the revenue categories are running about flat. And unit growth I would think would slow the support and deployment. But, any kind of color on the aggregate growth rate of services would be helpful. Thank you.

BRIAN GLADDEN: Yes, Keith. On the support side we've been living with a lower unit growth environment for a while. The team has done a very good job of driving growth in that business with improved attach rates, as well as just execution. I would also say that as you think about infrastructure, cloud, security, apps, BPO, these are places we're making investments today. We're doing in some cases some pruning in those businesses to improve profitability. We've seen that actually happen. And I would say that that's a place that we would expect to see increasing growth as we move forward.

KEITH BACHMAN: Okay. Great. Thanks very much, Brian.

ROB WILLIAMS: Thanks, Keith. Regina, let's take one more question.

OPERATOR: We'll now take our final question from Ananda Baruah with Breen Murray.

ANANDA BARUAH: Thanks, guys, for taking the question.

Brian, just going back to gross margin, if I sort of wrap all your comments together, it actually sounds like you feel pretty good about where you stand with regards to the margins at this point in the year, relative to your expectations. I guess you mentioned getting pressured by PC ASTs obviously, but you said you actually think components feel maybe a little bit better than they did three months ago, and enterprise should help as you go through the year. So, is that an accurate assessment of your comments, I guess? And if so, should we actually still expect your margins to improve as we move through the year on the gross margin side?

BRIAN GLADDEN: Yes, I think, Ananda, you hit some of the tail winds that I think should help here. Clearly, the mix of the business and driving stronger growth in enterprise solutions and services has to be a key element of the story. The biggest challenge, or the new dynamic that we're facing into is really client pricing and the competitiveness that we see there. So, if we can balance those things as we move forward, we would expect to see gross margins relatively stable or improving.

ANANDA BARUAH: Thanks, and just a follow-up, if I could. Have you gotten a sense -- pretty clearly, you guys walked away from some lower-end business on the PC side. Do you have any sense of how you did, relative to the market in the mid-range and higher end PC ASP bands, that you're focused on?

STEVE FELICE: Yes, we think we fared well in the mid and high price band. One good example is we know we're doing really well with our XPS 13, our first ultrabook. We know we're taking a lot of share with that. And I think even if you look at some industry data like what's selling in retail in the U.S. you'll see those results. So, we think we're faring well there and in certain geographies we know we're holding our own. So, where we are losing share it's in places where the profitability is very low.

ANANDA BARUAH: Got it. Thanks a lot.

OPERATOR: We'll now turn the call over to Mr. Williams for closing remarks.

ROB WILLIAMS: Thank you. I don't have any closing remarks.

OPERATOR: This concludes today's conference call. We appreciate your participation and you may disconnect at this time.

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