Dell Inc.
Fiscal Year 2012 First Quarter
Earnings Conference Call
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OPERATOR: Good afternoon and welcome to the Dell Inc. First Quarter Fiscal Year 2012 Earnings Conference Call. I'd like to inform all participants that 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 tar 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 of Investor Relations.

Mr. Williams, you may begin.

ROB WILLIAMS: Thank you.

With me today are Michael Dell, Brian Gladden and Paul Bell, President of our public and large enterprise business. We have posted our web deck on dell.com and we released a V-log on Dell Shares. I encourage you to review these materials for additional perspective.

In Q2, we will attend the Bernstein Conference on June 1st. We will be hosting our analyst meeting on June 28th and 29th, and our stockholder's meeting on July 15th.

Next, I would like to remind you that all statements made during this call that relate to future results and events are forward-looking statements that are based on our current expectations. Actual results and events could differ materially from those projected in the forward-looking statements because of a number of risks and uncertainties,

which are discussed in our annual and quarterly SEC filings and in the cautionary statement contained in our press release and in our web deck. 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 relations portion of our website at Dell.com and in the press release included in the 8K filed today.

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.

We're pleased with the progress we're making in advancing our strategy, and the impact it's having on the company's results. More than a year ago, we committed to a growth strategy based on delivering efficient and flexible IT solutions for the virtual era. This strategy is built around two primary objectives, accelerating our investment in enterprise solutions and services, and improving our execution in our core client business.

Over the past several quarters, you've seen us execute on our commitment to build, develop, and grow our solutions capabilities. These include organic and inorganic investments in storage, services, security and systems management. As we transition to more Dell-owned IP, we're selling higher value and more differentiated products, and we're having deeper conversations with our customers about their technology challenges and opportunities.

We're seeing significant trends like driving better product mix to Dell storage offerings and higher margins for value sold in our services, server, and networking offerings. As such, we're capturing a growing share in the faster growing segments of the IT profit pool.

Today, our client business is radically improved form where it was three years ago when we first moved into retail, and began our transition to more contract manufacturing. We're seeing significantly improved profitability across our client, desktop, and mobility business that would have not been possible without concerted efforts of our procurement, global operations, product organizations to reduce cost across the value chain, and simplify and improve our product offerings.

We're also selling a higher value client portfolio, and seeing improved sales execution across the company. These strategic initiatives coupled with our focus on intellectual property, product innovation and differentiation are driving our business results. Our gross margins and operating income margins have improved across our lines of business, and in each of the four customer segments.

We're pleased with our progress in this strategy, but recognize that we still have a lot of work to do. We think our first quarter results, again, demonstrate the profound changes we're driving in the company as we execute on our long-term value creation commitments.

So, let's review our first quarter results. Key performance metrics are provided for your reference on pages 5 and 6 in the Web deck. Revenue in the first quarter was $15 billion, up 1 percent year-over-year, and down 4 percent sequentially. Our enterprise solutions and services business grew 5 percent to $4.4 billion. While we did see strong growth in several key areas this quarter, like small and medium business, Asia Pacific-Japan, and our server business, our overall revenue was slightly weaker than our outlook as we saw slower growth from our consumer

business, and some budget related timing weakness in the public sector.

We gained or held revenue and profit share in most of our key customer segments and product verticals, maintaining a healthy balance of profitable revenue growth across the business. And we continue to believe that profit share is more important than unit share.

On a GAAP basis, operating income was $1.2 billion, or 8.1 of revenue. And we delivered earnings per share of 49 cents. Earnings per share was up 188 percent year-over-year, and 2 percent sequentially.

For the rest of the call I'll refer to non-GAAP financial measures. We delivered 23.4 percent gross margins, driven by continued solid supply chain execution, a shift of product mix to Dell IP, and higher value products, and continued component cost declines. Pricing discipline also remains key for us, as we continue to prune and eliminate lower margin business, that's not accretive to the company.

OpEx was $2.1 billion, or 14.2 percent of revenue. We continue to invest in all the areas that will benefit Dell for the long-term, and shift to a more specialized sales force. Enterprise product specialists now make up nearly 30 percent of our sales spend. Moreover, our R&D spend has shifted dramatically over the past two years to favor enterprise solutions and services versus client R&D.

Operating income grew 67 percent to $1.4 billion, or 9.2 percent of revenue. We continue to focus on areas with accretive margins and make appropriate tradeoffs to trim lower margin business in places like S&P, and our storage portfolio. All of our segments showed improved operating leverage in the quarter. The commercial segment as a whole delivered 11.1 percent operating income representing a 340 basis point increase from the previous year. And we achieved our second quarter in a row of

record operating profit in our large enterprise and small and medium businesses.

Interest and other expenses were $42 million, driven by approximately $60 million in quarterly interest and offset by investment income. For the quarter our tax rate was 21.3 percent, driven by an increase in earnings attributable to lower tax jurisdictions. Earnings per share increased 83 percent year-over-year to 55 cents per share. In the quarter we generated $465 million in cash flow from operations and have now delivered 4.2 billion in the trailing four quarters.

Our cash conversion cycle was a negative 31 days, working capital and our cash conversion cycle were adversely impacted by a reduction in our days payable, which is driven by a slight shift in production and procurement linearity, and seasonal buying patterns. Days inventory increased by one day due to strategic purchases of commodities. We expect our cash conversion cycle should move back to mid-negative 30s over the course of the year. We ended the quarter with $15.2 billion in cash investments, and in the quarter we repurchased $450 million worth of stock.

Now, let's take a take a look at our lines of business and regional performance, which you'll find on pages 11 through 15 in the deck. Enterprise solutions and services revenue grew 5 percent, to $4.4 billion, driven by solid performance in servers and services. Server and networking revenue grew 11 percent, with commercial services revenue increasing 6 percent. Demand for blades and networking was up 23 percent and 32 percent respectively.

This quarter we also launched our vStart offering to provide customers with fully configured virtual machines. Our storage business declined 13 percent year-over-year, mainly due to declining revenue of EMC products. However, Dell-owned intellectual property, which now

includes Compellent, EqualLogic, PowerVault, and DX Object Storage, grew 11 percent in the quarter. We're pleased with our acquisition of Compellent, and the strong pipeline that's developed in the two-and-a-half months that we've owned the business. Our fiber channel opportunity with Compellent is now larger than where we were a year ago with EMC. And we're confident in the growth plans that we have for this business.

Dell services revenue grew 5 percent to $2 billion. Transactional support revenue grew 5 percent, and was mostly attributable to attach-based services sold to our commercial customers. Outsourcing revenue grew 3 percent. The total contract value of new contracts signed over the past 12 months was $1 billion. Following a year of elongated sales cycles, we're now beginning to see a progression in our sales pipeline and a greater number of deals coming to closure.

Project and consulting revenue grew by 13 percent, with infrastructure, applications, and business processes projects all delivering double-digit growth. Our services backlog is now $14.1 billion, and is split between $6.9 billion in deferred services revenue, and $7.2 billion in contracted services backlog.

Turning to client, we continue to see the corporate refresh play out as expected, with client revenue and large enterprise up 7 percent, while SMB grew 1 percent. Overall, client hardware revenues fell 2 percent to 8 billion, driven by weakness in public and consumer, which were down 10 and 5 percent respectively.

Software and peripherals grew 3 percent, to 2.6 billion, and represent 17 percent of our revenue now. We have significantly improved the profitability in our S&P business over the past few quarters, and continue to exit portions of this business where margins rates and returns are unacceptable.

Geographically, revenue in APJ, and EMEA grew 15 percent and 1 percent respectively, while revenue in the Americas was down 3 percent. Taking a further look between growth markets and developed countries, growth markets outside the U.S. and Canada, Western Europe, and Japan now account for 27 percent of our revenue. And they grew 17 percent over the previous year. BRIC countries grew 18 percent with India up 28 percent, and China up 22 percent.

Turning to our segment-level performance on pages 16 through 20. In our large enterprise, public and SMB segments combined, revenue grew 3 percent to $12 billion. The combination of these segments delivered $1.3 billion in operating income, or 11.1 percent of revenue, and was up 340 basis points from the previous year.

Our small and medium business had a very strong revenue and profit quarter. Revenue of 3.8 billion was up 7 percent, to the highest level in two years, driven by strong demand across all product lines. Servers and storage revenue were up 19 and 7 percent, respectively, while our client hardware grew revenue up 1 percent. We delivered operating income of $463 million, or 12.3 percent of revenue.

As we move through the quarter consumer demand was weaker than we had anticipated. For the quarter consumer revenue was down 7 percent to 3.0 billion and down 8 percent sequentially. Even as revenue decelerated, our profit improved significantly, and we delivered $136 million in operating income, and a 4.5 percent operating profit rate. Keys to the progress include a new simplified brand strategy and improved products, and shift to higher value products, a better mix of profitable retail, and structural and component cost improvements in our supply chain.

Now, I'll turn it over to Paul Bell to discuss our public and large enterprise performance.

PAUL BELL: Thanks, Brian.

I'll start by echoing Brian's comments on our strategy. As we continue to innovate and bring differentiated IP to our portfolio our business is more solutions-focused than ever before. Our solutions feature designs that are open, capable, and affordable, all attributes that provide customers with tangible benefits around efficiency and flexibility. This is important, because our dialogue with customers these days is especially focused on productivity and efficiency of IT.

For instance, in our public business budget cuts dampen spend on the client refresh. However, the same budget issues are having the opposite effect on server consolidation, virtualization, efficient IT services, anything that can drive structural cost reduction for customers, given the budget challenges they're facing. Simply put, customers everywhere are looking to do more with less money, while at the same time capturing resources to focus on innovation for their users and their customers.

This is where Dell's new solutions begin to resonate with customers in an overall cost-level. When we say Compellent requires nearly 50 percent less disk capacity versus traditional SANs, or security can be managed as a service via SecureWorks, or we offer multi-vendor support and can do so remotely, then customers really begin to listen. They've known Dell for open, capable and affordable offerings in hardware systems for over two decades now, and they're very receptive when they see the same value proposition brought to bear in their core enterprise infrastructure.

Second, none of our enterprise expansion would be possible without the investments we're making to enhance our sales and solutions delivery capabilities. Over the past year we've added more than 5,000 growth resources, a 50/50 split between additional sales resources and

engineers dedicated to the development of enterprise solutions and services.

Third, we're sustaining our flow of organic and inorganic investments. Following a string of enterprise acquisitions we've announced last month our expansion organically into building out new customer data centers and solution centers. Our multi-quarter initiatives are evident to our customers. They know our commitment is real. They know we're going to sustain it, and they've giving us the right to play as we design new products and services for them.

Turning back to our business unit results in Q1, we maintained pricing discipline, and drove a strong mix of enterprise and services business, resulting in year-on-year operating income growth of 24 percent in public, and 78 percent in large enterprise. Our public revenue is down 2 percent to $3.8 billion. We continue to see a mixed demand environment here, with budget challenges both in the U.S. and in Western Europe, but with strong growth in Asia.

Enterprise Solutions and Services revenue was up 3 percent, while total client was down 10 percent. Overall public operating income was $370 million, and improved 210 bases points to 9.8 percent of revenue. In large enterprise, segment revenue was up 5 percent to $4.5 billion led by an ongoing hardware refresh. Client revenue was up 7 percent; server growth was up 6 percent. OpInc as a percentage of revenue improved 460 bases points to $504 million, or 11.3 percent of revenue.

Overall, the public and large enterprise business represents about 55 percent of Dell's revenue, and about 60 percent of the company's operating income. As our solutions folks gather momentum, we have a big opportunity to drive an even larger contribution in future quarters.

Now, let me turn it back over to Brian.

BRIAN GLADDEN: Thanks, Paul.

So, let's turn to our outlook. As we think about revenue for the second quarter, our public business will benefit from stronger spending among state and local governments, and education, as they close out their fiscal years. We also see our SMB and consumer businesses experiencing above average seasonality due to solid demand for Dell Sandy Bridge-based offerings, which are now widely available, good consumer back-to-school spending, and a refreshed portfolio of XPS products.

In total, we expect mid-single digit sequential revenue growth in the second quarter, which is slightly above normal sequential growth of 2 to 3 percent.

On the cost side, as we've been saying, the component cost environment is moderated, and the overall rate of deflation is slowing as we move into the second and third quarters. Despite this inflection point, we're confident in our sustainability of strong margins as we head into this environment.

On a quarterly basis, we anticipate interest and other to be around $70 million in expense. On tax, we continue to experience a higher proportion of our earnings in lower tax jurisdictions, and we now expect our full year tax rate to be between 21 and 23 percent.

The commitment to our strategy is working. We continue to innovate and own Dell intellectual property. And our teams are motivated to grow revenue, sustain pricing discipline and operating income growth, and deliver cash earnings.

As we move through Fiscal Year '12, we expect improving demand dynamics in the markets that are critical for us. Our strong commercial client business with continued refresh tailwind, coupled with our expanding enterprise mix

with strong demand for our Dell-branded storage and services, and our significantly better positioned consumer business all give us confidence that we can deliver on our revenue outlook of 5 to 9 percent growth.

In our outlook for the rest of the year, we're very excited about the ramp of Compellent, and our growing services pipeline, and believe Dell-owned storage and Dell Services are positioned for above-average industry growth.

And in servers, we continue to execute a move to more differentiated and higher value products that should continue to drive above market revenue and strong margin performance.

As you recall, our operating income growth outlook for the year was for 6 to 12 percent growth versus last year. Our strong first quarter earnings results are a great start to the year, and we're now raising our total year operating income growth outlook to 12 to 18 percent.

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

MICHAEL DELL: Thank you, Brian.

We're off to a solid start in FY '12. Our substantial profit increase demonstrates that our strategy is working, and our execution is improving.

As Brian said, we are laser-focused on executing our strategy to drive efficient and flexible enterprise solutions for the virtual era. We're moving much more into the core of IT, and into the data center, increasingly with our own intellectual property. We fine-tuned our focus on three key solution domains, next generation computing solutions and intelligent data management; services, security, and cloud; and end-user computing.

Each of these solution domains represents key areas where Dell has to win. As a design principle, we're creating

solutions that are open, capable, and affordable. This is an increasingly differentiated position that customers love.

We built a significant leadership position in servers, having sold around 15 million of them during the past decade. Now, we're extending that strength further into storage and networking. In servers, this quarter we launched vStart, which combines server, storage and networking and management software to provide customers with hundreds of virtual machines that are preconfigured and ready to run.

In storage, we're really excited about our Compellent acquisition, and the tremendous ramp and customer enthusiasm we're seeing for our newest SAN solution. This quarter, we also launched our first NAS product based on our Exanet architecture we acquired a year ago.

Combined with our number one position in iSCSI storage, we're quickly becoming a technology leader in intelligent data management. Without own IP, we expect this will continue to be a source of expanding margins, and profits.

In services, Steve Schuckenbrock has refined our strategy, and you'll see we're focused on winning business where Dell can lower the overall cost of service delivery. To get there, we're building out capabilities in multi-vendor support, and remote infrastructure management, security, and application management for the data center.

We also launched an initiative to invest a billion dollars to add solutions-focused resources to build our data centers and solution centers to help our customers as they begin to migrate to private and public clouds.

As our results demonstrate, our strategy is working well. We have the strongest IT solutions in our history, and we appreciate the trust and confidence our millions of customers place in Dell each day.

We'll have more to share with you about our strategy and the IT solutions we're creating at our meeting in June. We look forward to updating you all then more on our progress.

With that, let's open it up for questions.

ROB WILLIAMS: Thanks, Michael.

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

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 *1 on your telephone keypad. You will be announced prior to asking your question. If you would like to withdraw your question, press the # key.

One moment please for the first question.

Our first question will come from Maynard Um with UBS.

MAYNARD UM: Hi. Thank you.

I'm just trying to understand how much of the gross margin strength is sustainable, even if we head into a stronger component headwind. Is there a way to quantify how much of the upside was the component pricing environment versus the structural changes you've made?

And then, my second question is on visibility on these larger contracts. Is it right to assume that the rollouts happen over multiple quarters, so you do have some recurring nature to them, and if so, any sense of what percentage of your enterprise refresh revenue might be viewed as recurring?

Thanks.

BRIAN GLADDEN: Thanks, Maynard. I'll take the first part, and then Paul can take a shot at the second one.

This is a similar conversation to one we had last quarter. We continue to be focused on driving operating income as the priority. Again, we've seen pretty good improvement over the past three quarters, and in general we're exceeding the long-term value creation OpInc target that we talked about over the last two quarters.

We're updating our outlook in terms of the operating income growth for the year to 12 to 18 percent, which we think is pretty good progress. So, there is some sustainability and a track record here. We're focused on operating income. Again, this target is a 7 percent GAAP number.

So, I mean, we've been leaning on profitable growth as the priority, and we've done that over the last few quarters. The teams are focused on balancing that growth again with operating income and profitability and cash flow.

So, we're not going to provide gross margin, or OpEx guidance, and I don't intend to parse the individual elements of that performance. We've talked about progress in things like driving to higher value products and services with stronger intellectual property. We've got simplification in cost activities going on the product lines that we've talked about for multiple quarters. And I would tell you that we feel pretty good about the progress in the supply chain there. We're pruning and eliminating business that we're seeing isn't strategic for the company. And then, we've been managing our pricing fairly well in terms of optimizing growth, but also clearly leaning on profitability.

So, a lot of things that I would argue are sustainable, at the same time it has been a good component environment, and we're prepared for the change, and the inflection point in terms of what component dynamics are going on right now. So, that's sort of the view on margins.

I'll let Paul talk about --

PAUL BELL: There's no question that you get some very large engagements with major public or corporate accounts, they can spread over many quarters. We actually just won one a few weeks ago that will be for 600,000 client systems over multiple years. And clearly that would be recurring revenue, and we think about it in terms of how we stage that, and execute that over multiple periods. But you have everything from that extreme down to pretty large refreshes that might be done as one chunk in a quarter.

So, a lot of our large business is the kind that we can plan out for overtly like that. There are others where we have contracts to give us the right to go sell over a period of time, and we're pretty confident on win rates at this stage, so, yes, there is a lot we have that helps us plan.

ROB WILLIAMS: Thanks, Maynard.

Next question.

OPERATOR: Our next question will come from Richard Gartner with Citi Investment Research.

RICHARD GARTNER: Thanks very much. Brian you talked earlier about confidence in the sustainability of "strong margins." Your 12 to 18 percent growth target, though, for non-GAAP operating income implies a deceleration back to zero, or negative growth, in operating income during the back half of the year. And I just wanted to get a sense of if that is, indeed, the way you're viewing the progression of the year, or whether you view the 12 to 18 percent number as duly conservative for the year?

BRIAN GLADDEN: Richard, I would go back to, we're pleased with the first quarter, good results. We've sustained pretty strong operating income levels for the past few quarters, and again, we're taking up the outlook for the year. We're

focused on driving to this 7 percent GAAP operating income target. Our outlook for the year implies pretty dramatic improvement, year-over-year for the total year, toward these commitments. And we continue to focus on balancing profitability with growth and cash flow, as kind of the priority.

So, what I would say is, it's early in the year. It's one quarter into it. We clearly have some uncertainty in the demand and commodity cost environments, and we'll continue to monitor the environment and work to optimize within the framework that we see in the environment. So, in that context we're still driving to these long-term value-creation sorts of targets.

RICHARD GARTNER: Okay. Then the follow-up, I guess, is which do you see -- I guess it's a follow up to Maynard's question, which do you see being a bigger factor as we progress throughout the year. It looks like you are expecting operating profit margins to decline throughout the year. Is the bigger factor going to be the component environment, or is it going to be a conscious decision on your part to reinvest some of this margin that's above your longer-term target back into higher growth rates? Thanks.

BRIAN GLADDEN: Again, I think it's a balance of trying to optimize, given what the environment gives us. We would. The targets we've given you clearly imply stronger revenue growth in the second half of the year. We're trying to balance that equation, deliver strong profitability, again, the 7 percent target is something we're focused on, and managing to get to the 5 to 9 percent growth is clearly a priority, as well. So, I think we're going to manage that as an equation, it's not as simple as commodity deflation, or pricing. It's sort of all one big equation around how we manage the business.

RICHARD GARTNER: Okay. Thank you.

OPERATOR: Our next question will come from Jayson Noland with Robert Baird.

JAYSON NOLAND: Thank you. A question for Brian on OpEx, we're up sequentially into a Q1, and I recognize some of that is Compellent, and some of it is additional value-add sales people. But, is there anything else going on there that should be discussed?

BRIAN GLADDEN: Yes, Jayson. I wouldn't call it anything unusual. We've been saying for a while that the shape of the P&L is going to change over time, as we move to become more solutions oriented, enterprise products and services become more central to the company. The investments that we're making are the things we've been talking about, enterprise R&D, sales specialists, and sales resources to drive the growth. I would say things like G&A we're working hard to basically hold those essentially flat as we move forward. So, again, we're focused on operating income growth and with the margin improvements that we've seen, it's allowed us to really fund the strategic initiatives that are longer-term and focus no the profitability targets that we're talking about. So, we'll continue to make those investments, monitor the environment and we'll adjust them as we see fit, and managing to the operating income.

JAYSON NOLAND: Is there anything you can say qualitatively on an absolute basis, should we expect OpEx to be kind of flat to up, off current levels?

BRIAN GLADDEN: Yes, we're not going to provide either gross margin or OpEx guidance specifically. But, as we see strong profitability in the business, we're going to continue to invest for the future.

JAYSON NOLAND: Thanks, Brian.

OPERATOR: Our next question will come from Toni Sacconaghi with Sanford Bernstein.

TONI SACCONAGHI: Yes, thank you. I have one and a follow-up, please.

Regarding your revenue guidance, as you mentioned, Brian, you're expecting a pretty dramatic acceleration in the second half. If I take the mid-point of your revenue guidance at 7 percent, I get your second half revenue growing 12.5 percent over your first half. You haven't done that in eight years, that kind of growth rate.

So, can you talk a little bit about what you see as unique factors in the second half? You highlighted Compellent, but it's simply not big enough, quite frankly. So, what is it that you see either about Dell's initiatives, or about the market environment that leads you to at least recently a pretty unprecedented acceleration in revenue growth in the second half. And I have a follow-up.

BRIAN GLADDEN: Yes, Toni. I think as you think about 5 to 9 percent, clearly in that it has to be a stronger second half. We expect that in general the market should improve over the course of the year. We also believe, and we have a differentiated view around how we expect to exceed the market forecast for demand growth. And that's not just around client. Clearly the client business is weighted more towards commercial versus consumer, where the growth is stronger, and clearly pricing and margins are stronger.

The consumer business we think is in very good shape, and well positioned to grow, and grow faster than the market, and particularly in higher value segments of that market, with higher revenue. We're gaining revenue and profit share in key growth countries, which we think are growing in double-digits clearly around the world. There's investment that are going in, and they've been going in now for multiple quarters around adding sales resources on the enterprise side of the business, and we again think we can grow at above market rates there, with more capacity on the sales side.

The server growth is driven by good position in blades, DCS, and moving to higher value offerings, and higher revenue per box in the server space. There's good progress. Storage is a bit of a mixed bag. Clearly we have pressure versus, given the EMC deterioration of revenue. But, again, as you know, the Dell-owned IP is growing -- should grow faster than the market, and is going to be higher margins for us, as well.

And then services, we've talked about this in the past, but it has the benefit of the dynamic with a growing deferred balance that's sort of accelerating here, and that will affect the support services, and the pipeline in outsourcing services looks pretty good. So, I think it's important that you kind of put a different lens on the company as you think about revenue growth, and recognize that the portfolio is increasingly more diverse, and that we have several places that we think we can grow faster than the market, and impact the overall revenue growth rate of the year.

TONI SACCONAGHI: Okay. Thank you for that. I also wanted to ask about cash usage. You significantly accelerated your share repurchases this quarter. I think you had been doing about $200 million a quarter for several quarters. And that was up to $450 million this quarter, despite the fact that your cash balance was lower, or certainly your ending cash balance was considerably lower.

Can you talk about whether that was opportunistic, given your stock price, or whether you're getting more confidence in your business outlook, and we should be thinking about this level of repurchases as a more sustained level on a go-forward basis.

BRIAN GLADDEN: Toni, I would say we haven't changed our capital allocation strategy that we've been communicating. We're still prioritizing investments, organic and inorganic investments that are in line with the strategy that we've been talking about. Cleary M&A is an important part of that. CapEx is

up this year, as you know. Those are things that are prioritized. We've said, I think, that we would use between 10 and 30 percent of our free cash flow for buy-back activities. That's kind of where we are for the quarter, and we're not really going to provide guidance around where we go with the buybacks from here.

TONI SACCONAGHI: Thank you.

OPERATOR: Our next question will come from Brian Alexander with Raymond James.

BRIAN ALEXANDER: Yes, just struggling a little bit to understand how the mix can be having such a pronounced effect on your consolidated operating margins, just looking at Dell's overall performance, operating margins are up over 350 basis points, which is incredible, but your enterprise solutions is only increased to 30 percent from 28 percent, I think, year-over-year, which isn't that dramatic. So, if I drill down on the mix shifts within the customer segment, there also doesn't appear to business such a dramatic mix shift towards enterprise. So, can you just explain what I might be missing here, because it doesn't seem like the mix is footing with the margin improvement in enterprise.

BRIAN GLADDEN: Yes, clearly mix is one of the drivers. And it's clearly where we're focused in terms of strategically driving the company. But, the reality is, for us to drive that sort of improvement in profitability, margins have to go up across the portfolio, and that's what happening. So, driving the higher value products and services, and solutions across every segment of the business is what's happening here. And the mix is helping to contribute to that, but it's profitability generally going up everywhere.

ROB WILLIAMS: Yes, I would just add that, specifically the way this has worked is we've had the opportunity to look at what we're doing with each customer. There are fundamental challenges, how do we add more value and look at how we can be the best partner across their whole IT spend.

So, this isn't just about the volume of units that we sell to each customer, it's how we add the most value, and there's a mix shift within. Even in the client business, we've seen a faster growth in our revenue than units as we have really delivered with our latest generation some real competitively differentiated client products. And so we're moving to the higher end of the price range, and getting more value out of that, and that is playing out across other types of products and services.

So, it's more mix within the lines of business than you described rather than across the lines of business.

BRIAN ALEXANDER: That's helpful.

Just to follow-up, it sounds like you guys are fairly bullish on the commercial PC refresh cycle. But if I kind of add up the client business within your commercial segments, it looks like the client business within commercial is flat year-over-year, so I just wanted to clarify that, and just understand that a little bit better. If you're bullish on commercial PCs, why was that flat year-over-year?

BRIAN GLADDEN: I think the client business in commercial was actually up, I think 5 percent. So, it's clearly the area that -- it's up 5 percent on a revenue basis across the business in the quarter. So, it is clearly differentiated versus the consumer space, and we continue to feel good about the refresh as we look out over the course of the next multiple quarters.

Paul, refresh?

PAUL BELL: We're back to sort of solid growth in IT spending, which puts you into IT budgets growing in the mid-single digits. We had very pronounced growth in commercial last year as people were recovering from the depth of the recession, and starting to execute on the projects that they knew would have a good ROI.

So, when we see mid-single digits growth, and we see that as sustainable, that's saying that we're in a pretty solid environment, and it allows us to work with our customers and pick the right deals, the ones where we can apply the pricing discipline, where we can add real value that isn't just selling them the hardware, but it's a whole Win7 migration, or helping them implement applications that are going to important to the next generation of their products. That picking and choosing allows us to ride what is a solid refresh cycle, and make sure we're driving strong margins.

ROB WILLIAMS: Brian, this is Rob. I would just clarify that point a little bit.

Our total client business was up 5 percent year-over-year. If you actually look at within the commercial and public businesses, and I don't want to break down every single one of those businesses, but for example in our large enterprise business notebooks were up 16 percent year-on-year. If you look at the public businesses, as you know, there were some timing related items there that we talked about on the call. So, we did have a negative in both desktops and notebooks in the public business. But then, in SMB both desktops and notebooks did grow year-over-year.

So, you've got a little bit of a mix going on there, public versus commercial in there. But you're definitely still seeing some signs of a refresh, although clearly we're coming down off of some pretty phenomenal rates, two or three quarters ago, off of some very, very easy compares.

So, I think Paul mentioned this earlier, we're back to somewhat of a more normalized refresh cycle as opposed to the accelerated refresh cycle that we were seeing two to three quarters ago.

BRIAN ALEXANDER: Okay. Thanks for all the details.

OPERATOR: Our next question will come from Scott Craig with Bank of America.

SCOTT CRAIG: Thanks. Good afternoon.

Two questions around the consumer business. First, when you look at a year-over-year basis from a revenue perspective, Brian, how much of the consumer weakness is from, say, end demand versus you guys still getting rid of some lower profitable business, or pruning business, however you want to phrase it?

And then, on the operating profit, where are we in the improvement cycle in the consumer business? You've obviously done an awesome job in the last two quarters, massive improvements. But where do you guys feel you are with the whole getting the standardized products, and going to more boat versus air, et cetera?

Thanks.

BRIAN GLADDEN: On the first one, there's still pruning going on, there's still refocusing the portfolio. There's still a mix shift between regions around the world. There's clearly growth, we're seeing growth in the emergent countries, and that's a place that we're focused on, and we'll see continued growth.

There are other places where we're continuing to pr8une and focus our energy around higher margin, higher value products. So, there's still quite a bit of that going on. As we did say, I mean, the market itself is weaker than we had anticipated coming into the quarter. And that's just -- we've been talking about that for a year in terms of that general demand dynamic.

From a cloud standpoint, from a prioritization of activities within the portfolio, there's still work there to do. And as you think about how much we've got on the water, as you think about product launches that we've got coming over the course of the summer that will refresh much of the portfolio within consumer, a lot of that is going to be at higher margins, improved focus on the higher price points, and higher value products in that portfolio. I think we've

still got quite a bit to do there, and we're encouraged by the progress to be at this level of profitability with still that much opportunity in front of us, I think, is encouraging. And it allows us to appropriately manage that balance between growth and margins as we move forward, hopefully.

SCOTT CRAIG: Good. Thank you.

OPERATOR: Our next question will come from Ben Reitzes with Barclays.

BEN REITZES: Hey, guys. Thanks a lot.

I was wondering if we could take a different tack on the gross margin question. Based on my math, your outlook kind of implies 7 percent operating margin for the remaining quarters on average. I guess my question is, what is sustainable about the improvements that you've done, if you could just reiterate those again?

And, also, what isn't? Is there something maybe with sea shipping that maybe wears off? Is there something that you saw in the quarter? Was there anything with certain accruals or anything that's not sustainable, just to account for the sequential drop off, but also to offset that, what are the positive that keep it only at that rate?

Thanks.

BRIAN GLADDEN: Ben, I can't call out anything that I would call unusual or not an opportunity to continue to drive sustaining improvement in margins. Clearly, the environment externally is something we have to continue to watch and manage. As you think about commodity pricing, which is clearly moderating, as you look at how the markets play out in terms of overall demand, and as you look at pricing behavior in the marketplace.

So, the things that we've talked about in terms of differentiated products and the new launches that are coming, a clear focus and move to higher value products within and across the portfolio; execution that we've driven around contract manufacturing. We went into more fixed configurations, continued to increase the number of fixed configuration client products sold. Ocean shipment still is a big opportunity, and frankly the bigger opportunity with higher oil prices today. And we continue to focus there.

So, I mean, clearly those elements are generally repeatable. And then the reality, Ben, as you know, is continued focus on expanding that services business, focusing on driving more server growth and storage, and those elements will continue to mix up the company.

BEN REITZES: And then, thanks a lot. And then, just finally, what is your latest view on tablets? Are you seeing any of that creep into corporate, and do you think you can play if you, indeed, believe that trend is picking up speed?

MICHAEL DELL: We're engaged with a number of customers on the services side helping them deal with tablets from a security standpoint, manageability standpoint, and that's a near-term opportunity for us. We see the ecosystems coming together, probably taking a little longer than we would have liked, but as that comes together there will be some nice opportunities there.

Anecdotally, I think what we're seeing is that we can't really find a lot of companies that are going to have three devices for all of their users, yet the tablet in almost all the instances we've found is a third device. So, it's not exactly clear how many units are going to be sold. I think it will be a lot of units. Gartner says there will be 2 billion PCs in 2014. I think there have been 10 or so million tablets sold in the last six months. So, to put it in perspective, we're very focused on creating the solutions, and as the ecosystems come together having a very strong offering that intersects with when this is relevant, when their

applications, when security is in place, and real deployments are occurring. But, I'm not seeing this replacing either the smart phone or the PC in large numbers of organizations.

BEN REITZES: Thanks a lot.

OPERATOR: Our next question will come from Aaron Rakers with Stifel Nicolaus.

AARON RAKERS: Yes. Thanks for taking the question, and congratulations on the quarter.

The first question is going back to the consumer side of the business. At 4-1/2 percent operating margin, you guys have obviously attained your target long-term model. Can you talk a little bit about the sustainability of that, and whether or not we should think about that as being somewhat volatile over the next couple of quarters, or are we at a new level where you think you can run at it, and is that a clean number? I know in the past when you guys have seen quarterly moves like this, there's been some one-time items in those.

BRIAN GLADDEN: Aaron, it is a clean number. It's good execution. And we're pleased with that. Over the past couple of quarters, I think you've seen this progress, and so a lot of things that Steve Felice talked about last year at the analyst meeting, and when we had him on the call in, I think, the third quarter, so, a lot of good execution.

We're not going to provide targets for individual business segments. Again, I think what we said was, we weren't satisfied with the profitability when it was below 2 percent, and again we've seen nice improvements. We did talk about the fact that this is sort o the level of profitability that we'd ultimately like to see in this business, and that's pretty consistent with what we said even a year ago over a longer term time horizon. So, we'll continue to balance growth

with profitability, and we're pretty pleased with that profitability right now.

AARON RAKERS: And the follow-up for me is on the PC side in general. I think in prior quarters you've talked about or provided unit growth numbers. Can you provide those for notebook and desktop, and on that talk a little bit about what you're seeing currently in the pricing environment in the PC industry?

BRIAN GLADDEN: We don't provide unit growth numbers, no. Not something we're going to provide. We're focused, again, on revenue, and profit share more than units.

AARON RAKERS: Any comment on the pricing environment?

BRIAN GLADDEN: Yes, pricing environment, as we've been saying for a few quarters here, has been relatively benign. Maybe Paul can give you a view from a customer standpoint?

PAUL BELL: Yes, we've certainly made it less aggressive for us, because we're just not seeking out what frankly can be negative margin business in this industry, where people go on large reverse auctions and that sort of thing. We're focused so much on having deeper relationships with customers, where we're working across the whole span of their IT infrastructure that we're just not getting that as much. I think that has probably contributed to a more benign price environment, because we're not doing that, and that of course applies to the larger commercial space.

When we have more to come to the table with, with our new acquisitions, our enterprise portfolio, talk about fundamental transitions of their IT capability, then it just, makes the whole discussion about what we're going to price the client devices at a less critical path. So, I'd say the market is sort of average, maybe trending towards benign, but you can still get in some fights if you choose to. We're just trying to really focus on what is the value for customers.

AARON RAKERS: Great. Thanks, guys.

OPERATOR: Our next question will come from Chris Whitmore, with Deutsche Bank.

CHRIS WHITMORE: Thanks very much. I'm having trouble reconciling your margin guidance with the rest of the commentary on the call, regarding business mix trends, pricing trends, demand trends, et cetera. Can you maybe lay out the top two or three drivers that will take operating margins down from, on a GAAP basis, 8 percent plus to 7 percent over the next couple of quarters?

BRIAN GLADDEN: Well, Chris, I think we've kind of laid out the key drivers that we think are impacting margins as we move throughout the year. We're not going to continue to break that down. I think as you think about the second half of the year, we're one quarter into it. And as you think about the uncertainty we may have here and the demand environment, and the competitive environment, and commodity costs, we're just going to kind of manage through that. And I think as you think about the framework that we've got, we're going to drive these elements that we've highlighted here that we think will generate positive results and react to what the market will give us. So, again, we're one quarter into it, we'll continue to provide insights on how we're viewing that over the course of the year.

ROB WILLIAMS: Yes, I would just add to that, pretty consistently for the last two years we've been very focused on operating income results, cash earnings performance, and regardless of the environment that we found ourselves in and it has been a fairly varied environment over the last six or seven quarters, we've fairly consistently delivered, and in fact I would say consistently delivered on our operating income commitment.

That's really the focus of the company. And I think that if you look at the ability to balance the different factors, whether it was a very difficult component cost environment, say, a year or so ago, to a more favorable component and cost environment now, then layering in the environments that we've made, the sales force, the specialists, there's been a lot of work that's been done here, and we've done that all with an eye towards operating income dollar growth, and frankly it's been pretty consistent.

So, that's really what we want to get you guys to focus on. We need to have the flexibility to manage the business on a quarter-by-quarter basis, and drive that balance that we're seeking to achieve.

CHRIS WHITMORE: Thank you.

OPERATOR: Our next question will come from Amit Daryanani, with RBC Capital Markets.

AMIT DARYANANI: Yes, thanks a lot. It's two questions. One, on Japan, can you just talk about if you saw any revenue or commodity and margin headwinds emanating out of Japan, either in the April quarter or in the quarter you guys are guiding for?

BRIAN GLADDEN: Yes, in the quarter we did have some slight revenue and cost pressure from the market disruption. The revenue, to be honest, was slightly less than we anticipated and we did incur some logistics and supply chain pressure, and incremental cost to ensure that we delivered on customer commitments. But, I would tell you it's pretty immaterial overall to the results, and we're not even calling it out.

The good news is that demand is returning to more normalized levels. In some cases there could even be upside, as it relates to restructuring base, or reconstruction kinds of activities in Japan. We continue to watch components, but in general we've feel like the supply chain is pretty solid, though we will incur some probably some

incremental costs in the second quarter, around that supply chain. Again, I would call it immaterial to the overall. So, we'll just continue to monitor it, but we're optimistic that we're kind of through this, from our standpoint.

AMIT DARYANANI: Got it. And could I just go back once more to the margin questions. If you look at your numbers, Op margins have gone up by 370 basis points, with very limited revenue growth, how much of that 370 basis points growth do you think was due to sustainable and controllable factors that you've been executing on, or such things like commodities that maybe a little bit out of control at this point?

BRIAN GLADDEN: You know, I mean, singling out commodities as a driver here is a bit dangerous. The reality is it's an execution sort of model that we have to drive taking into account commodity prices in any environment. And as you think about the things that we've done to drive progress in the business, it's around the products and services that we're offering. It's an increased mix in solutions. It's good execution and supply chain. It's moving to higher price points and higher value products. It's more solutions. It's all these things that we've talked about, and we've detailed over the course of multiple quarters.

AMIT DARYANANI: Do you think all the things you're talking about is the bigger, or more than a 50 percent driver of the margin expansion?

BRIAN GLADDEN: Absolutely.

AMIT DARYANANI: Fair enough. Thank you and congratulations on the quarter.

BRIAN GLADDEN: Thanks.

ROB WILLIAMS: Go to the next question, please.

OPERATOR: Our next question will come from Shannon Cross, with Cross Research.

SHANNON CROSS: Thank you very much. My first question is just with regard to linearity during the quarter. Can you talk about whether you saw things improving and maybe on a segment basis? That would be helpful.

BRIAN GLADDEN: You know, Shannon, I wouldn't call out anything unusual, in terms of linearity in the quarter. I mean we did have the Easter holiday towards the end, but other than that I wouldn't say there was anything different in terms of linearity than you would typically see in the quarter.

Paul, you may have a different view.

PAUL BELL: Yes, in general, that's right. It was pretty consistent to the forecast throughout the quarter, at least in public and large enterprise, the one exception being the federal government, which is just a piece of our public business, but you have real sustained budget cuts throughout the year at an extreme stop, as everybody was just waiting for the continuing resolutions in the budget. But, that's less than a quarter of our total public business, and I think we balance that out pretty well.

SHANNON CROSS: Okay, great. And then I'm just curious, if you think about where you've gone about sort of going into your enterprise customers, and your public customers, and looking at where you can add value added services and sort of digging down into them. What inning do you think you are, in terms of sort of optimizing the revenue opportunities of these customers, are we early days, or is this something where you've been doing this for several quarters?

ROB WILLIAMS: Well, let me come at it from two perspectives. One, we've been at the relationship building side of that for 27 years, and I'm not being flip. That's a very important part of the equation, that when we come to them with new capabilities from what we just acquired, or we have developed a new solution, we have an incredibly receptive audience, because customers have worked with us and seen what open,

capable, affordable solutions mean. Then if you actually talk about the solutions themselves and what inning we're in, well, with some we're in inning one and we're still in the dugout, because we've just bought the company. But, you've got others that we've been really working hard at and we're in the third, fourth, fifth generation of the products.

So, you really have to look offer-by-offer to see where we are, but really the important thing is that we're really leveraging the direct relationships we've had with these accounts. We know them. We, unlike many of our competitors, have one account executive whose job it is to represent all of Dell, know everything they can about that account and their challenges. And so that's how I think we accelerate demand in our solutions.

SHANNON CROSS: Have you changed sales comp plans at all in Fiscal 2012 to drive more profit, or revenue?

ROB WILLIAMS: Yes, ma'am, we've put much more focus on margin as we drive more high-margin products. We also in some businesses that had not gone to it yet, we extended the quota cycle, so it was too short when it was quarter-by-quarter. So, a lot of the world had already gone to a six-month plan, or in some cases an annual plan. Now everybody is on the longer plans, because it takes a longer sales cycle to close these.

SHANNON CROSS: Great. Thank you.

OPERATOR: Our next question will come from Kevin Hunt with Auriga.

KEVIN HUNT: Hi, thank you. I just want to follow-up on the storage question. Some of this has been touched on, but if you kind of look at what you guys report on storage, it was pretty weak overall. Even the 11 percent you guys reported for the high IP businesses was down, a fairly substantial deceleration for what you've been doing in those types of businesses in the last year or so. And it was well

below -- not well below, but below what NetApp and EMC were doing.

So, you kind of seem to be implying that that business is going to accelerate, so I kind of want to just get some more basis for why we should think that's going to accelerate going forward, and then also maybe a comment on when the EMC, and maybe legacy PowerVault business, sort of hits such a small number here where we're really seeing pure growth from that higher IP stuff?

BRIAN GLADDEN: We absolutely think it's going to grow. I mean, as you think about it, we're in a quarter where we're continuing to build out the portfolio and a pretty dramatic shift in the focus. There's obviously a lot going on with the close of the Compellent transaction, and the EMC Dynamics in the quarter, we've added significantly to the storage specialist population.

As you think about that, there's just a lot going on in terms of distraction amongst the team. But, again, margins continue to expand overall, even within the quarter. The pipeline looks very good, very optimistic about that, and we expect to see strong growth there. The lead times, and the close cycles on some of these transactions is actually longer, especially on the PLE, or the public and large enterprise side, and we begin to see that, some of those deals begin to flow through the pipeline as we move forward, especially on things like Compellent.

In our SMB business, for instance we have fundamentally almost completely replaced the EMC revenue with Compellent revenue, quarter-on-quarter. So, this has a much shorter kind of close cycle, and the impact of that is much more dramatic in a quicker timeframe. So, I'm very encouraged about that. We do expect this will accelerate pretty aggressively as we move throughout the year, as we get past the first quarter.

KEVIN HUNT: So, should we also assume that means for the total business we should be maybe one or two quarters away from hitting an inflection point where that starts growing substantially, because there really isn't much more left to lose on EMC?

BRIAN GLADDEN: Yes, I think we'll start, as you get towards the end of this year, clearly driving positive revenue and year-over-year growth. I think it's been declining for a while, but clearly you saw an acceleration towards the end of the year.

ROB WILLIAMS: We had margin growth in the quarter.

BRIAN GLADDEN: Absolutely.

MICHAEL DELL: And that's been going on, on a year-over-year basis, for a long time, as we continue to change out the portfolio. Q1 was a dramatic change out, and high confidence in our ability to grow storage margins and revenue going forward.

ROB WILLIAMS: Yes, we've own Compellent for less than a full quarter, and the number of sales people out there introducing Compellent technology to customers is up by an order of magnitude. So, most of that went into building the pipeline, and so we're very bullish about the deceleration there.

KEVIN HUNT: Thank you, guys.

ROB WILLIAMS: Great. Let's go ahead and take one more question.

OPERATOR: Okay. Our last question will come from Abhey Lamba with ISI Group.

ABHEY LAMBA: Yes, thanks. Michael, just following up on the tablet question, can you talk about how do you plan to participate in this space, which operating systems will you build it out on, and where do you see the most demand from your enterprise customers?

MICHAEL DELL: Well, clearly for us we're in the Android and Windows camp. I think Windows really starts to become relevant in the Windows 8 timeframe. There's a lot of activity around our microprocessors, obviously, in tablets, to get the thin and low power, lightweight characteristics. So, those are really the attributes. When you go into the enterprise customers are looking at security. They're looking at applications. They're looking at kind of a robust set of offerings. Those are still being formed. And we're very much active with a number of partners to kind of create those and form them. And as that all comes together I think you'll see us be very present in that market. So, it's Android Honeycomb on the tablet side. And I think we're still seeing earlier release versions. That needs to get a bit more mature.

ABHEY LAMBA: All right. Thanks.

And lastly, Brian, now that you've achieved your operating margin level in the consumer business where you wanted it to be, do you have room over here now to go for market share gain, or are you going to continue to improve upon margins in that business?

BRIAN GLADDEN: We're not changing the strategy. We're going to continue to lean on profit. We think we're in a spot now where we can begin to grow the business, as well, while maintaining some pretty good profit.

MICHAEL DELL: See, I think the broader point here is that we have an improving product line execution and that, along with the change in our approach to our customers, where we've changed the conversation to be more solutions-based, is really opening up a new set of opportunities for us, and I think that's what's contributing to the strong growth in earnings that you're seeing.

ABHEY LAMBA: Thank you.

ROB WILLIAMS: Great. Well, thanks to everyone for joining us. We look forward to talking to you over the course of the quarter and would remind you that we have our analyst meeting here in Austin on June the 28th and the 29th.

Thanks, again.

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

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