2012 Citi Technology Conference
Steve Schuckenbrock, Dell President, Services
New York, NY
September 5, 2012

JIM SUVA, Citi: Thank you for joining us for the Citi Technology Conference. In this session, it will be Dell. I'm Jim Suva, the Tech Hardware and Electronic Supply Chain analyst here at Citi.

On the stage with me is Steve Schuckenbrock, the head of Services. The format of this is going to be a fireside chat, where Steve and I will talk about a few prepared comments, overall big picture, about his company, and then a little bit on the services versus products. And then there's going o be ample time for investor Q&A. I want to remind you to please wait for the microphone to come to you before asking your questions. But please start to get your questions in mind as we're going to be coming your way shortly.

Before I start off our discussion with Steve, I have been asked by Dell to read the Dell Safe Harbor Statement. I would like to remind you that all statements made during this meeting that relate to the 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 Dell's annual and quarterly SEC filings, and in the cautionary statement in Dell's Q2 Earnings Press Release, and web deck. Dell assumes no obligation to update forward-looking statements.

Please also note that Dell will be referring to non-GAAP financial measures, including non-GAAP gross margins, 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 Q2 Earnings web deck posted in the Investor Relations section at Dell.com. I encourage you to review these documents.

With that said, I would like to kick things off, and I'll join Steve on the chairs up here, with kind of a key bigger question. Steve, how would you kind of characterize the current demand environment for your products versus the first half of the year, say, versus the second half of the calendar year? Better? Worse? In line? How are you kind of seeing things from where you sit?

STEVE SCHUCKENBROCK, Dell: Well, I gave some guidance at the last earnings call a few weeks ago that basically said we expected the environment to be about down 2 to down 5 percent. I'm not here to update any of that guidance. Essentially, you know, as we looked at the second quarter, we saw a really good demand for our enterprise products, as well as our services. That demand is pretty encouraging relative to the strategy that we have. And then we saw some unexpected weakness in the PC space, particularly with some challenges in the emerging or growth markets. And so no updates for the guidance we gave a few weeks ago.

JIM SUVA: Specifically, Steve, to that geographic, you mentioned some geographic regions. Maybe if you could just go ahead and start talking about Europe versus Asia versus North America, Latin America, some of the areas of strength as well as some of the areas of maybe lackluster kind of demand that you're seeing?

STEVE SCHUCKENBROCK: So, overall, I know we've been somewhat encouraged in the North American healthcare and federal government space. It began to show some better signs versus previous quarters in the second quarter. We continue to see good strength in our SMB business, and really solid strength in the SMB business relative to the enterprise products. And that is really a North American, but a global statement. That business continues to do well.

Softness in the consumer business globally. There is no question that our expectations in the PC business were not met. And when we look at China, Brazil, India, all of them went from double-digit growth to double-digit negative in the course of a single quarter. And so you look at that as an anomaly that we're still trying to make sure we've got our arms fully around.

When you look at Europe, overall Europe has executed about where we expected them to, which is not necessarily where we would all like, but pretty consistent with what's happening overall in that economy.

JIM SUVA: Great. And then when we think about Dell and its use of cash, you recently announced a dividend to shareholders, which is nice. Can you talk about your priority use of cash? A lot of people think about stock buybacks, maybe money used for acquisitions in your services side of things, or other strategic ideas, as well as dividends, capital deployment. Can you talk about your intended uses and priorities of that cash?

STEVE SCHUCKENBROCK: I think we've been pretty disciplined on the acquisition side. We've made a lot, about 16 acquisitions, or I guess 18 acquisitions over the course of the last couple of years, and one pending. We intend to maintain a focus of growth through acquisition for specific IP that is valuable to us as we expand into this kind of new computing model that's evolving in the industry.

However, that is balanced against managing that capital structure, and the cash relative to shareholder returns, and the board did just authorize the dividend that starts in the third quarter. We have done a fair amount of share buyback, and we ultimately expect to return to the shareholders 20 to 25 percent of free cash flow based on those decisions around the dividend. And so, we feel pretty good that we're continuing to manage a disciplined capital strategy.

JIM SUVA: And as far as macro factors, whether it be GDP, employment rate, hiring, hours worked, things like that, what are some of the macro things that you look at there as a manager within Dell as far as potentially how this impacts Dell?

STEVE SCHUCKENBROCK: It's pretty tough to say. But I would say we track pretty well to the IT spend. If you look at the IT spend analysis that's done by your firms, and others, and you look at how that correlates to GDP, that's probably the neighborhood that is the best tracking mechanism for the potential of our markets.

JIM SUVA: And then when we think about your company, you know, we're looking to spend a few minutes talking about say the last five years, as many in this room know Dell from kind of a PC product-centric, and you're kind of in a phase of transitioning more towards a services role, and it's great that you're in charge of services. Can you maybe walk people through kind of the past five years, and kind of where you're going, about that transition, where we are through it, and what we can look forward to?

STEVE SCHUCKENBROCK: Sure. First, it hasn't changed dramatically over the course of the last five or six years. If you think about, we had about a $10 billion enterprise and services business five years ago, and now it's about a $20 billion business as we sit here today. And the growth momentum of that business is significantly changing the mix of the company where now 34 percent of the business is revenue from services and the enterprise business, and a little over 50 percent of the profit comes from those two areas. And so that is a good indication that our strategy is working, and we're beginning to see the mix shift that we looked to. Obviously, we want that to be the majority of the company from a revenue standpoint as we project out into the future.

When you consider all of the elements of the transformation, acquiring and integrating companies; investing in our own IP and R&D capabilities, which we're now investing quite heavily in relative to anything that we've done in the past; shifting the culture to a solutions culture versus a transactional culture; all of these are really important pieces of work that I think are just taking the time that they take.

As we look back to any analogues like this in the past, not to say that we're trying to emulate any of these other companies, but if you look at IBM it was a ten-year transition really from the hardware company to a solutions company. We're in the third or fourth year. I would characterize -- you asked a five-year question, I would characterize the first couple of years as really kind of a turnaround of some basic blocking and tackling that needed to be done in the business. That went quite well. We certainly able to get the margins up, and do a lot of positive things in the company. And the last two to three years have been really focused on this transition to a solutions company.

JIM SUVA: And now looking ahead, say, the future strategy for the next five years, can you talk a little bit about both those opportunities and what direction you think it's going to; and also to be balanced and fair, what are the challenges of going down that road?

STEVE SCHUCKENBROCK: Sure. In terms of the opportunities, this industry is going through a massive change, and that change calls for much, much more standardization. Standardization around X86 type hardware, and open systems is the DNA and the heritage of Dell. And so we have nothing in our path that's proprietary that we're trying to protect, and that's a really positive sign given the fact that the customers are now shifting fairly rapidly off of the proprietary backbones of the past on to X86 and cloud-type platforms, which is right in our sweet spot.

So, a lot of the services capabilities, in fact our value proposition to our customers is not a traditional outsourcing value proposition. It's let us help you migrate from your legacy past to a much more cost-effective, more flexible, faster environment. And I don't mean processing speed, although that's fine, too. But the ability to adapt to the changing marketplaces are the reality of today's business. And we're winning a lot of deals on the back of that.

These last two acquisitions we did with Make and Clerity are specifically in the services space, they're specifically targeted at helping customers move off of those legacy systems to the future. Now, when you consider what those systems, those new applications will run on, it's a converged stack of network, server, storage managed through one pane of glass allows you to migrate workloads between your own private cloud to public cloud and back, and to be able to monitor the service levels and the overall resource utilization in both situations. That's kind of the dynamics of where Dell will play, and will win.

JIM SUVA: When we think about your services, is there a certain percent that you find are attached to the hardware or PC unit? Like at Citibank, you know, you find that half of your servers are attached to deploying the hardware within Citi. If you walk us through the correlation of your services and the hardware side of things?

STEVE SCHUCKENBROCK: Sure. Our services business is about $8-1/2 billion, and if you look at that business there are four major sections to it. There is the support services business. And one might look at that as just kind of attach it to the box, and it sort of sits over here in the corner. It's a good cash machine. Actually, it's a great basis for innovation. And what we found in that business is multi-vendor support, ability to support every asset in a data center and provide a comprehensive service across the entire data center. Our ability to attach things, even like remote consulting, where we now schedule time with our technicians on behalf of our customers, and get into a consultative dialogue on how they manage the configurations in their data center, the deployment of new assets or new technologies in their data center, and that sort of thing, but also deployments and configuration management, which are things we've traditionally done well. We're putting a lot of innovation into that engine.

The second piece of the business is infrastructure and cloud computing. And that business has some traditional outsourcing through the acquisition of Perot, but is quickly migrating to what I said before, how do I move my customer base and their applications from a legacy past to the future. And that really is the characterization of so many of the deals we're doing today.

One I'll reference this morning is CoreLogic. They provide all of the information underneath the real estate industry, from a consumer all the way through the government, about seven petabytes of information and their applications all run on mainframes. We've just engaged with them to migrate off of those mainframes to X86 and cloud infrastructure from non-Dell storage to Dell storage and a seven-year relationship in order to make sure that we not only complete that migration, but optimize their compute environment going forward.

That's a perfect example of what we do in the infrastructure and cloud computing space. One of the things that's a subtlety that's a huge Dell advantage in this space is by having a big support business where we manage 30 million events, we have 11 million parts dispatches a year. We've got 30,000 people. We operate in 142 different countries and 60 different languages. You talk about this notion of RIMO, which is remote infrastructure management, so that you can sit in a cost-optimized location and manage the events on computers anywhere in the world through the network or through the Web.

We have that RIMO type capability, but having that RIMO type capability sitting with that support services capability means not only can we monitor, but we can take action on those events anywhere in the world. So, I think that capability will underpin our outsourcing business in a very effective way and provide us a cost structure and a service structure that I think we can use to differentiate ourselves.

The third big area is applications and BPO. That's a very good area of the business. We have done some pruning of assets in that space, where we just had contracts who were not going to be profitable over the longer-haul and it put a management structure in place that allows us to go to market vertically across government, healthcare, banking, financial, securities, and insurance, and the rest of all of commercial.

And we have really great assets in all four of those areas and are winning deals around the world. We've just completed a great implementation, for example, with GOME in China, which is kind of the Best Buy of China, a huge business using Dell's distribution application assets as the backbone of their new supply chain across GOME. We just also implemented a new e-commerce platform based on Oracle with GOME. That's just an example of the kind of applications work that we're doing and I see that business as having a tremendous amount of potential customers wrestle with moving their applications to mobility, to social media, and to the cloud.

I'm sorry, the fourth one was security and we bought SecureWorks a few years ago, a couple of years ago. Secure works is -- it will be two years in January, but SecureWorks has grown very, very nicely. We've had record signings quarter after quarter, after quarter, in that business. The revenue is up very, very significantly. We combine our security business and our infrastructure and cloud computing business for external reporting. But, the revenue in the security space is great, up about 35 percent last quarter.

But, more importantly, this game does a world-class job of protecting our customers, like big financial institutions from the hackers and the sort of business theft that occurs too much in business today. And we monitor now -- when we bought them we were monitoring 13 billion events per day. Now we monitor more than 30 billion events per day on behalf of our customers and we're able to triage through really sophisticated IP those 30 billion events, isolated to the couple thousand that are serious new issues and then against those couple thousand make sure we put the right inoculation in place and the right protection in place with our customers. And for a city who may not see an event first, we can actually pick it up at some ambiguous location with a small regional bank in Canada, understand the nature of that threat, and put the inoculation in place before a bank like Citi would ever see it.

JIM SUVA: Interesting, very interesting. So, how is the time, I want to make sure we've got ample time for investor Q&A. You actually have about 15 to 20 minutes left and I have a whole laundry list of additional questions I can keep asking Steve up here, and talk about my family and twins, and I'll bore you to death, or you can start raising hand and asking questions. All of a sudden the hands start popping up when I mention my family stories. So, if you would please use a microphone.

Keep in mind I want to remind you that Steve is actually head of services. So, while I'm sure he can speak some to products, his real core background is on services. So, just keep that in mind.

QUESTION: With that in mind, just a quick question on products, you mentioned last quarter emerging markets China, Brazil, et cetera, went from double-digit growth to negative growth in a quarter. Do you guys have any insight into why that happened and how Dell is going to respond to that in the next couple of quarters?

STEVE SCHUCKENBROCK: Well, I would say, different answers in different places. I'll just pick those three. First, let's start with India. I mean, there's been some pretty significant pressures in the economy in India more recently. There's some conservatism in the spend in India that I think came to light more acutely in the second quarter than we would have expected. And I think that will sort of work its way through the system and I think India is really a function of the economy there and some of the short-term issues that they have faced. But, we're very bullish on India in the longer-term and we see good performance. Our brand is exceptionally well positioned in India and our servers and storage continue to do quite well there. So, it was really in the PC space, and somewhat of a consumer phenomenon there, as well.

In China I think there's more of a dynamic around the channel and some move more towards a low price band position in China where we had chosen not to compete. We have been focused on mid and high-price band offerings. We saw a bit of a shift more towards low price. And we have been very disciplined about not taking a unit for a units' sake in order to grab share. And so we passed in a very disciplined way on some deals that would have been marginal from a shareholder standpoint.

And so we think that continues to be the right discipline and obviously over time before a mid-price begins to change. In Brazil we actually had a very good sales quarter, however, the headwinds relative to currency were more than we anticipated and we wound up with some currency issues that offset an otherwise very good performance. And so there's not one answer, but that should give you a little bit of a feel.

JIM SUVA: Next question from investors, please raise your hand?

QUESTION: I think, Steve, it's fair to say Windows 8 coming down the pipeline, using services, can you talk about Windows 8 and how Dell, internally, is positioning itself and at the same time the challenge that people are throwing out there is, hey, Microsoft is now building physical products, including their Surface. Can you talk about Windows 8, the opportunity, as well as that challenge?

STEVE SCHUCKENBROCK: First, I think Windows 8 is a great opportunity. I've had a chance to play with it a little bit. It's an exciting product. And I think people will respond extremely well to the new interface within Windows 8. We do think that there is somewhat of a suppression and demand in the short term, as people reposition their inventories to Windows 8, as it gets announced here relatively soon. We certainly think that there are some new devices that are going to be exciting that take advantage of all the things people like about the tablet, and the things they like about the PC. And some of those new sort of in-between products we unveiled in Berlin. I think it was in Germany this past week, that feedback has been terrific for.

So, we think Windows 8 is a whole new wave of technological innovation that we think will be good for Dell, and good for users, and frankly give our commercial customers a choice. There's really only been one tablet choice up to this point in time, and now from Dell you will have a tablet choice, you will have an in-between device, and a whole suite of laptops that are very thin, light, and the feedback and awards have been phenomenal for those devices. And so we think Windows 8 will create some very good momentum, even though it may suppress some things in the short-term.

When you look at what Microsoft is doing with Surface, frankly, Microsoft is stimulating their ecosystem towards the kind of innovation they think complements their operating system, and what they choose to do long-term with that device, or how that unfolds I guess the market will be the judge.

JIM SUVA: Investor question?

QUESTION: Can you talk about on the enterprise side Microsoft has said that I think like 60 percent of the commercial XP install base has moved to Windows 7. So, I would just be curious as to your take on how much of a tailwind you guys have received in your commercial PC business from the migration, and what might happen after that is complete?

STEVE SCHUCKENBROCK: Well, I think commercial organizations especially, once you get an IT staff, if the company is 500 people, 1,000 people, or more, tend to take their time with these migrations. I don't know if 60 percent is right, 50 percent, you know, the number I've also heard, but it's in that range. And so there's more deployment still ahead of us relative to Windows 7, and I think there will be a certain demand for Windows 8 that comes from the consumer experience and the expectations that they'll have a similar kind of experience with their devices at the office.

And so we think we've certainly capitalized on the new innovations around Windows 7, and the feedback around Windows 7 from the customer base has been quite good, and I think you'll see that continue right along into Windows 8. It will certainly be a phenomenon in the consumer space first, and somewhat in small business, and then I think you'll see a migration towards Windows 8 in medium to large enterprises over the next couple of years.

JIM SUVA: There's a question up front, and the microphone will make its way up to you here in one brief moment.

QUESTION: Thank you. Could you talk a little bit about the competitive dynamics in this space, and I guess the reality is the Asian PC OEMs have taken quite a bit of market share from you and HP, so what do you think about that? I mean, what are some of the reasons? And what is Dell doing to actually compete more aggressively with the Asian PC OEMs?

STEVE SCHUCKENBROCK: We've seen this phenomenon over the last number of years, and it kind of comes and goes to some extent. We certainly saw -- I won't name names -- some of the competitors run a very, very lean price-oriented model, and one mistake away from really decimating the financials of the company. And they're running, call it a 10-8-2, but that's being generous, a 10 percent gross margin, 8 percent OPEX, 2 percent OPINC kind of a business in a volatile currency environment, in a volatile product environment, with the dynamics of new operating systems, and new form factors coming into the market, there will be times when it looks like it's working, and there will be times when it looks like it was a really bad idea. And so I think we're in a time where those companies are taking share with some very aggressive pricing tactics, mostly in the low end, low price points.

We're doing much better in the mid to higher price points. We've decided to put our focus on mid to higher price points. We think that in the long run that's going to be the right strategy, and we don't see that a 10-8-2 kind of a model is the right thing for our shareholders, and for the long-term value we want to generate for our customers in this business. Having said that, we are managing our cost records very aggressively, and you're going to take a couple of billion dollars of cost out of the business over the next couple of years, a billion of that is going to be in the PC space, and we will take a very, very hard look at everything associated with that space from how we design and engineer the products all the way through how we sell them, and how we support and service those products to make sure that we've optimized the cost structure for competitiveness.

QUESTION: (Off mike) -- go after the commercial market more so than consumer, where obviously they did have some success. Are they in particular a special threat to, again, a Dell, or maybe an HPQ, or do you think that the fact that they're able to run at much lower margin is not sustainable, as you seemed to indicate?

STEVE SCHUCKENBROCK: I made my comments about sustainability. I think there's short-term opportunity and risks in that decision. I don't want to speak for their strategy. I never take a competitor for granted. I understand what they're saying they want to do. We've got an exceptionally strong business in those spaces. We think converged technologies around the data center are going to make a huge difference, and we think that where you were running converged technologies using your own IP is a much better way to go versus some of the decisions and alternatives that they're pursuing. And we think we'll fare quite well. But, again, never take them for granted.

JIM SUVA: And we have a question immediate behind, about two rows behind you, sir.

QUESTION: Thank you. Dell has always been a great generator of cash, part of it has been the working capital, part of it has been your lean model. But in the first half of this year, it was pretty tough, and can you just talk about going forward, how you see that if revenues are going to be declining, does the working capital go against you? Can you offset that in other ways?

STEVE SCHUCKENBROCK: We had -- first of all, what the cash quarter we wanted, and certainly revenue, and the associated profit is a huge contributor to that. I think the other question that is kind of implied in here is in the cash conversion cycle, which was 30 days instead of our traditional 32 or 33. I think there was a two to three day kind of issue relative to the day sales outstanding. I don't see that as a big headwind for us going forward. And then there was a little bit of noise in the inventory number, mostly associated with the timing of our sales in the last week of the quarter, and our inability to get those units shipped on time.

So, I would put the emphasis on making sure we drive growth and continue to maintain the disciplines around our profitability versus any kind of business model shift.

QUESTION: Relative to service acquisitions, can you give us some idea of the mix of acquisition spending you're likely to do software versus services? Are there enough services acquisitions out there that are attractive that that could be a big part of your acquisitions going forward?

STEVE SCHUCKENBROCK: Let me -- I'm not dodging your question, although I can't give you a specific answer, obviously. When I look at the services business, I'm very bullish on the security space, I'm very bullish on the apps and the VPO space. When I look at the infrastructure and cloud computing space, there may be IP that's valuable to us, but we certainly have the ability to do more organically, and grow faster organically, particularly outside the U.S. And we think that there is no reason for a big inorganic play in addition to what we've already done in that space. I think the support business is extremely strong and healthy.

So, now I'm going to give you the kind of broader and I think more important answer, which is our customers really do want to buy solutions. They don't want to buy piece parts, services over here, software over there, hardware over there, and the days of specifying the architecture in a services deal I think are more and more behind us than they are ahead of us. So, the days of customization and the old legacy models that many of my competitors have sort of built their lives around, I think they're diminishing.

And so, I don't really care which combination of acquisitions we pursue between enterprise hardware, software, and services. I do care about how well we work together to combine those into solutions that our customers can get with one simple sales and buying motion, as opposed to the historical complexities around those purchases. And I think you'll see us bring servers, storage, networking, systems management, all the associated with services prepackaged, pre-bundled for problems like big data, for problems like rationalization of your whole SharePoint environment, or for solutions like private clouds, or ERP implementations, or whatever the case might be.

And you'll wind up, I think, growing on the back of how well those things are combined together, versus on sort of individual pursuits out of what would traditionally be thought of as lobs in other companies.

JIM SUVA: We have time for about five more minutes of investor questions. There's a question in the middle and then following the one in the middle we have a question from the back of the room.

QUESTION: I have a question on your tablet strategy, and as you cut in PC, what kind of R&D requirements and different types of R&D do you need to do in this area.

STEVE SCHUCKENBROCK: Well, I tried to update you n the tablet strategy. I think, beyond what I've said, if we have a brand new tablet that we just showcased in Germany, if you go to Dell.com you can see across the tag a glimpse at our new tablet, as well as our new XPS all in one 27-inch device, as well as our new Duo laptop that converges between a laptop and a tablet, which are all very exciting, portable, ease of use, Windows 8-based platforms. And we think that there's a lot of value for our commercial customers and those platforms and real value for consumers, as well, but our focus is very much on serving what our commercial customers have told us and that is there are problems associated with bringing an iPad to the office. They're not compatible. The applications don't all work. You're hostage to the ecosystem of Apple. Management of that environment is increasingly difficult. Security has been a real problem. You can kind of go down the list.

So, we think our capital strategy, in conjunction with Windows 8, which solutions around that set of problems, not the least of which is the Windows apps that they've developed over the last 20 years will now work in that environment. That's a pretty powerful value proposition for commercial customers that we think is going to make our tablet strategy quite successful. And we certainly aspire to have share in the tablet space in the commercial sector that is like the share we have in our PC business.

JIM SUVA: There's a question right in the back of the room.

QUESTION: I have a follow-up on acquisitions, services, are there any limits on the size of an acquisition you might make, just in a general ballpark?

STEVE SCHUCKENBROCK: I don't know how to answer a limits question. We're not going to go -- we're not really out pursuing a big services acquisition. I think we've got a great foundation in the business that we have. It's performing exceptionally well. We think we can get more growth out of the engine than we have and don't need to do that through acquisition. However, we could be stronger in certain verticals and there are opportunities to do that without doing something really, really big, and we see some tuck-in acquisitions around certain of horizontal IP that could be interesting in areas like social media and areas like mobility, so on and so forth.

And so I feel very good that we have the right foundation and the right platform, the profitability and the services business has expanded, I think, each of the last six quarters. And we had real momentum out of our applications, specifically in the cloud computing business, and their applications in the BPO business from a profitability standpoint, and if you look at the signings in the first half of this year, which is about a $1.2 billion, $1.3 billion and you look at the mix of those signings, there are incrementally new customers, 88 percent of those signings were brand new customers. There are incrementally new industries, 75 percent of what was outside of our traditional strength of government and healthcare. And they are geographically diverse.

In addition to that, about two-thirds of it were infrastructure and cloud computing and a third of it was applications and BPO. And so I feel like the sales engine and the deal flow is conducive to good organic growth off the foundation we have and that allows us to be selective and profitable about the kind of acquisitions that complement that foundation.

JIM SUVA: We have concluded our time now with Dell. I want to personally thank Dell and Steve Schuckenbrock, head of services for Dell, for joining us. And thank you, ladies and gentlemen.

STEVE SCHUCKENBROCK: Thank you.

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