Credit Suisse Technology Conference

Brian Gladden, Dell SVP & CFO

Scottsdale, Arizona

November 28, 2012

KULBINDER GARCHA: Okay, I think we'll get started. My name is Kulbinder Garcha. I'm the IT hardware analyst for Credit Suisse, and I'm very pleased to have Brian Gladden the CFO of Dell here.

Before we start, I've been told to read this Safe Harbor statement. I would like to remind you that all statements made during this meeting that relate to future results and events are forward-looking statements that are based on current expectations. 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. Dell assumes no obligation to update forward-looking statements.

And please also note that we'll be referring to non-GAAP financial measures, including non-GAAP gross margin, OPEX, operating income, net income, and EPS. Historical non-GAAP measures are reconciled to the most directly comparable GAAP measures in the web deck posted on Dell's Investor Relations website.

BRIAN GLADDEN: Thank you.

KULBINDER GARCHA: Okay. So, thanks for coming to the conference, Brian. If I start off with a few maybe broad questions, and can you speak about as we head into year-end, how things are going for the second half of the year, how the conversations with your customers have gone with respect to IT budgets, their purchasing decisions, how the market is impacting them, and any update on how maybe Black Friday went for you guys?

BRIAN GLADDEN: Yes. Well, as you guys know, 80 percent of the customer base is really commercial customers with a big business in mid-market, small and medium business important for us. I would say, as we've seen the year play out, you've seen a lot more of our customers really delay purchases given the macro-environment. We still feel very good about pipelines and opportunities across the enterprise portfolio. I think you could say the same thing about the refresh opportunity that's still out there on the Windows 7 corporate customers, and we think that's still in the somewhere between 40 and 50 percent of that refresh still has to happen.

But I think the short-term behavior that we're seeing is clearly that people are pushing back on discretionary spending in and anything they can hold off on. We do expect to see, as budgets get refreshed heading into next year, some of that activity move forward, and are relatively bullish on the pipelines. But that's clearly something we've experienced for the last six months globally.

KULBINDER GARCHA: And it's been on a global basis, too, across all geographies, all verticals?

BRIAN GLADDEN: Absolutely. The corporate base that's been a global dynamic. And then, on top of that, you've seen emerging countries, you talk about India, you talk about Brazil, over the last six months with currency what's happened there has really slowed down discretionary spending. And that is for us a broad impact across the enterprise portfolio, but also consumer in those markets.

KULBINDER GARCHA: If we start going through some of the business lines or the markets you play in, and if we start with the client business, and there's obviously been lots of macro impact in being in the emerging markets as well.

BRIAN GLADDEN: Yes.

KULBINDER GARCHA: As we look into going forward, whether it's the next few quarters, the next 12 to 18 months, do you see actual opportunities for growth in the PC industry per se, and how specifically are Dell trying to position in this because you have been pruning a little bit? Is that in case you have to maximize profits? How are you going to try and play this the next few quarters do you think?

BRIAN GLADDEN: I think it's highly uncertain. The demand environment from a PC standpoint has clearly over the last three to six months, the last two quarters for us, been somewhat impacted by the whole Windows 8 transition, inventory changes in the channel across the globe, and this emerging country -- the emerging countries were such a big part of the growth in the PC business, and when you see what's happening to those markets, they dramatically slowed down in the last two quarters. We don't think that's a long-term trend. We think that the emergent countries obviously get back to reasonable growth. And there are some pockets where we would expect to see improved opportunities. The Wyse acquisition with the virtualized desktop as an offering in that space is doing very well. I think when you look at Windows 8 and some of the new tablets that are coming with Windows 8 and the touch-enabled devices is a positive and net driving growth. But, it's very uncertain in terms of the foundational or fundamental PC demand. I think you could ask 25 people and get 25 different answers around what they think that's going to be over the next couple quarters, let alone the next two years.

KULBINDER GARCHA: And specifically for your business on the PC side, do you see the consumer business slip back into lost territory? Can you speak about some of the initiatives you have to try and get that at least back to a breakeven?

BRIAN GLADDEN: On the consumer side?

KULBINDER GARCHA: On the consumer side, and in the PC or the client business overall how you think about market share versus profitability, and how you want to optimize that business?

BRIAN GLADDEN: I think it's important when you look at consumer, it's important to us from a scale standpoint. The unit volumes there contribute to our cost position across the portfolio, not just in the client business and commercial, but also on the server side. So, having unit volumes and that supply base are important, and therefore the consumer business is important. BYOD also becomes a critical element of why we're in the consumer business.

That said, I think you have to continue to innovate, and I think we have to recognize that there are two parts of that business. You look at channel-based retail PC business, it's tough to make money, very difficult to make money really anywhere in the world, especially in developed countries. When you start thinking about what we do on the direct side of our business, where we can pull through services, where we have up-sell warranties, where we have financing capabilities, and software and peripherals that we sell with the boxes, that overall equation is actually pretty interesting for us, and we need to find ways to continue to grow our position there.

I think what you've seen over the last couple of quarters is really the slowdown in emerging countries has descaled that business from an OPEX standpoint. And we don't think that's a long-term trend or dynamic in terms of emergent countries. We think we have to be in a position to grow in those markets. And as unit volumes come back as we work through the Windows 8 transition, we think we'll be back to a moderate profit level in that business.

We still would target a 2 percent profitability in operating income in the consumer business. And I think over time you'll see us get back to that.

KULBINDER GARCHA: On the actions you discussed at the analyst meeting you're now putting through on the cost-based side, what are you trying to do there?

BRIAN GLADDEN: Yes. We talked at the analyst meeting this summer about a $2 billion cost opportunity across the portfolio. We're actually targeting more than that internally, and a fair amount of it is focused on the client business. Jeff Clarke has talked to some extent about what we're doing there, but it's simplifying the portfolio; it's moving to a broader set of simpler solutions in the client business. We've done some of that on the consumer side of the business. We've got more to do there. The legacy of the company being around custom-configured products brings a lot of cost with it, and we're not sure that customers really value that absolute custom configuration any longer. If we can move to a set of fixed configurations across the portfolio there's a fair amount of cost that really falls out of the portfolio of the business. So, that's what we'll do. And I think that enables us to continue to be competitive in the client business.

KULBINDER GARCHA: And if we move to the server side, one of the things that at least has surprised me has been the strength of the server revenue growth. Also, just even as the server market has been decelerating you guys have continued to gain share, also do it with fairly respectable margins. Can you speak about both the sustainability of growth and of profitability in that segment, and maybe elaborate on what you guys have been doing.

BRIAN GLADDEN: I think we're building on strength in the server business. Clearly there's a dynamic with hyper scale data centers driving demand growth. One would look at that part of the business and think it's incredibly dilutive. I think we've found ways in parts of that market to drive very profitable growth and solve very, very strong growth over the last couple of quarters in hyper scale data centers. ASPs have been moving up within that space, as well. Some of that is mix of business, and if we can not only serve the largest of web 2.0, or hyper scale data centers, but serving smaller players in that space, and serving a more diverse set of customers who actually value that technology. The margins there are very good. And that's been a big driver of growth in terms of unit volumes.

We introduced our new server line, the Romley-based products in the spring, with time to market advantages, and we think technology advantages. So, building on our share position globally, but specifically building on the technology that we've introduced there, we think that's helped us. Obviously, average selling prices have moved up, margins have moved up as a result of that. And we feel good about the sustainability of that, at least for some period of time. Now, the next generation will be behind that and we have to maintain some level of advantage there, but the technology we have in the marketplace we think is differentiated and as a result that's helping us gain share and move prices up.

KULBINDER GARCHA: Is there a risk that just on the ASP increases there that that mix shift upwards is played out and there's not much more to come, or how do you think about the opportunity.

BRIAN GLADDEN: I think we've consistently seen the macro trends in the data center, whether it's virtualization, whether it's consolidation, a lot of that has driven us to higher workloads, and higher end configurations. So, fully loaded machines that have higher ASPs and higher margins for us has been part of the dynamic that's helped us maintain margins there and it's a good thing for us.

KULBINDER GARCHA: How about on storage, I guess we've seen a recent deceleration. You guys have had a fairly good run with EqualLogic and Compellent, what happens with the storage business now going forward? Is it the more mature growth rate? Is it just macro playing on the results recently? How do you think about that?

BRIAN GLADDEN: I think it's a couple of things. We like the portfolio we built. Building on EqualLogic and Compellent as key assets there and integrating other technologies and intellectual property that we're acquiring around that I think puts us in a good technology position and customers are generally very positive on what we're offering today in mid-range storage. I think the market slowed down. Clearly across the competitive set in that space we've seen a pretty dramatic slowdown in terms of overall revenue growth. I would say we're holding our own, but we're not happy with that. We'd like to be gaining share, given the investments we've made there, and I think some of it is just us growing into the sales motion in that space. And we're working on that. I think it's just taking some time to get the right sales motion in place to sell more complex solutions that are based on a broader set of solutions here.

So, we would expect to grow faster than the market. I think the market is flatish, maybe down a little bit right now. And there's more work to do there, but still a very important part of the portfolio for us.

KULBINDER GARCHA: Maybe, Brian, can you elaborate on what's changing in the Dell sales force? This was touched upon by Steve at the analyst meeting as well. But, just in terms of what change you're trying to put through, where we are in the process, and what the end result you hope comes from all of this?

BRIAN GLADDEN: It really is changing our sales model in a -- to embrace solutions and to integrate more technical competency into longer-cycle, longer-term, higher-end sales motions. So, as you saw an OPEX line for our company over the last two years, we've added a fair amount of cost to the selling equation. Most of that was hiring specialists who are deep in storage, or deep in networking, or in some cases services. Those technology experts really have to integrate their sales motion into the generalist model that's core to what Dell has done historically.

So, figuring out when's the point at which specialists engage, how do we compensate them, are specialists focused on supporting a generalist in key accounts, or are they out hunting for new business on their own? Those are all things that I think we've had to work through and figure out within the context of the Dell model that's more direct than most of our competitors in those spaces.

So, I think we're still in the process of figuring out how the optimized model will work and it will be different in some regions of the world, it will be different in some parts of the business. But, I think that's what we've sort of realized and it's taking longer than we expected.

KULBINDER GARCHA: Is it a case of significant change in incentives across the organization, or is it more complex than that?

BRIAN GLADDEN: I think incentives are a part of the equation. But, clearly decision writes and how decentralized are you going to be in account ownership is something that we're working through. I mean, Dell historically has had these great customer relationships that are direct with an account executive who could sell the whole portfolio, as the portfolio has gotten more complicated we've had to rethink that and think about how those relationships play out with the various elements of the portfolio.

KULBINDER GARCHA: Maybe a few more questions from me before I open it for the audience, so the mikes can get ready. On the services side, I think the pipeline has been fairly decent and how do you think about revenue growth there, growth in margin expansion, are you guys having to do any pruning on contracts, as many of your peers are doing. Can you give us an update there?

BRIAN GLADDEN: Yes, well the services business, there's a support business that's tied to hardware sales that's very profitable, and to be honest the team has done a very good job in growing not only revenue and the deferred revenue balance that goes with that part of the business, but growing profitability there with higher ASPs, better attach rates, despite some of the unit volume impacts of that business. So, good execution there and I think that will continue.

The other side of the business is really IT outsourcing, apps, BPO, and cloud, and security, I would say more advanced services. That part of the business is where you've seen on ITO, and apps and BPO, places where we've pruned. And the portfolio itself, we're moving towards a more profitable set of customer accounts. And much of the activity that you've see with the basically $1.8 billion of new signings that we've averaged on a trailing 12 month basis for the last year is all going to be accretive, in terms of margin rates to that portfolio. Right now we're still going through that period of pruning and walking away. A fair number of what I would say in our portfolio are relatively large, but accounts that we're being selective in terms of what we resign. We'll stay with a customer, we'll offer them some selected services, but we're not going to take the full broad portfolio of things we were delivering before at margins that were too low. So, we're working margins up. I think you'll see us over the next six months begin to get to a place where we start seeing growth on that side of the business. And then, separately, security, which is primarily the SecureWorks acquisition we did a couple of years ago, has been a great success, and is growing very, very well, a good part of the portfolio in services.

KULBINDER GARCHA: And, are there any questions from the audience?

QUESTION: Just for the company going forward, how are you thinking about cash conversion? On the one hand, you have software right in through acquisitions, on the other hand moving away from the PC business, so how are you thinking about that?

BRIAN GLADDEN: Yes. Well, cash conversion cycle has been relatively stable over the last couple of years. There is, as you think about services and non-direct client business being faster growing elements of the portfolio, they would have less favorable cash conversion cycles, and probably argue that the cash conversion cycle will move down.

The offset that plays out, much of the things that we're adding to the portfolio, software with maintenance and license agreements, that tends to be cash up-front kind of business, it will see the deferred revenue balance will grow faster. So, from a free cash flow generation relative to net income, from an overall balance sheet standpoint, it's probably net-net favorable as that business grows significantly faster than the other parts of the business.

That said, if the core client business with direct to consumer and direct to customer shrinks fast, that is a headwind on cash conversion cycle and something we'll have to work through. We've talked about it at the analyst meeting that we think there's probably a one to two day pressure in cash conversion cycle on an annual basis as the mix of the business shifts. I would say the deferred revenue dynamic of software added to the portfolio is a bit of an offset to that.

QUESTION: Thank you. Two questions. First, if you could address the Microsoft Surface, just your view of competition with your existing business? And second, on Windows 8, maybe just your initial view post launch, and how you're thinking about your own product portfolio to address Windows 8?

BRIAN GLADDEN: I think the context is important around our focus on commercial customers, and enterprise customers, but even with client products, and that being the majority of our products, Windows 8 isn't necessarily a very relevant dialogue with the commercial customers probably until you get into even the second quarter of next year, post Service Pack 1. That is historically what we've seen. That's playing out.

The fact that there are tablet devices that with a full x86 experience in a Windows Pro offering are out there is changing that dialogue a bit. And I think you're starting to see, we're starting to see a lot of customers who want to test these kinds of products with their sales force where their applications all work, and security feels really good, and all of that is interesting.

In terms of notebooks and refresh, many of our customers still are in the midst of Windows 7, and that's going to continue to be their focus as you look out over the next at least year, year-and-a-half. We're bullish on the products we have in the marketplace with Windows 8. The feedback that we've gotten around the products themselves and the design is very positive. We've got an RT product that would be competitive with the Surface. Not clear where that really fits in, it clearly isn't something that commercial customers are spending a lot of time thinking about RT. And the consumer feedback and demand on that product for us is pretty good. It's actually over our expectations.

So, I think the Microsoft question around Surface from our standpoint, a lot of opportunity there in terms of new innovative products and devices there. I think Microsoft will be somewhat focused on the consumer space with RT in the short-term. And as these kinds of products sort of play out in the marketplace, lots of opportunity for everybody to sort of play there. And it's not clear to me what Microsoft's long-term game plan is there in terms of their position in that sort of space.

KULBINDER GARCHA: In the front row.

QUESTION: There's been a lot of talk about cloud, people trying to understand on-premise, off-premise. You have Boomi. You guys are working on Open Stack. Can you tell us with all of that what this offering will up?

BRIAN GLADDEN: I think it's still early days on cloud for us. I would say there's a lot of things we bring to the table. We think private cloud is, for a commercial customer especially if you think about mid-market, tends to be the priority. We're not spending a lot of capital in building capacity to support a big, broad public cloud offering. I think in the mid-market, for instance, it's a real opportunity for us to bring application modernization, and some of the acquisitions we've done with things like Make Technologies and Clerity, Boomi brings a toolset that enables that. That's an interesting conversation where we're seeing a lot of interest, especially in the mid-market.

And private clouds with advanced capabilities around how you manage that data and the security that you can put around it is something that I think is getting the majority of the interest for us. We've got a public cloud offering. We'll have pretty interesting reference architectures that ultimately we think will help us not only sell a lot of gear into cloud players, but will be the basis for our offering that we think will be very competitive, especially on the private side.

So, I would say stay tuned. I think we're starting to get some momentum around that, and we're learning as we go. And we just don't want to be in a place where it's a capital intensive space that is very dependent on making big investments to grow, and I don't think we have to do that given the portfolio of solutions that we bring to the table.

KULBINDER GARCHA: Maybe one final one from me, Brian, and this year Dell has been very active in acquisitions. First of all, how should we think about M&A going forward, and also maybe a quick update on where we are on the integration of all of these, which of them are going well, which of them are proving more challenging?

BRIAN GLADDEN: We spent $4.9 billion year-to-date on acquisitions, have done six that I would say are pretty core to the strategy, feel really good about SonicWALL and the success we've seen thus far, Wyse on the virtualized desktop side has been very successful. AppAssure in backup and recovery has been a nice add to the portfolio. And then Quest being really the big one that becomes the foundational platform for us on the software side.

Early days in Quest, but I would say we're very encouraged by what we're seeing in the portfolio as many of you know, that was a real rollup of a lot of different software assets, and we see it as we sort of work through that process and due diligence and understanding the company. Not only a lot of interesting portfolio products that help us and other parts of our portfolio aligned with cloud and aligned with our security focus, and aligned with systems management and some of the things we already have in the marketplace, but also an opportunity to run the place better.

And as you think about synergies in the deal model for us, John Swainson and his team really now running that as a business, using it as a platform and being able to bolt on other intellectual property and software, we think is a pretty powerful start for us, with scale, with a business generating close to $900 million of revenue on the way in that we got for a pretty good price relative to other software assets.

So, I feel pretty good about that one. I think there are things we can do to bolt around that and add technology to the quest foundation, and I don't think you see us -- you're not going to spend 4.9 billion again in the next year. I think these were pretty important elements of the portfolio. And I would say for the most part the key platforms are in place that allow us to now to additive, kind of bolt-on acquisitions that portfolio as we move forward.

And we've got some digesting to do. These are relatively sizeable acquisitions that from an integration standpoint. That doesn't happen over night. These are things that are over a couple of years you've got a lot of work to do.

KULBINDER GARCHA: Does the structure of Quest, and the manner in which it was created mean that just revenue synergy wise, in terms of the results for Dell, we're thinking about 12 to 24 months out, or what impact is it having with your customers, or how should we think about that?

BRIAN GLADDEN: I think we're seeing great initial feedback from our core sales force. So, you got 20,000 sales people carrying the Dell bag that are now beginning to learn about Quest products and lead generation, in addition to 2,000 sales people that came with the Quest deal. So, John is being very careful. We're not integrating those sales forces for the short term. I think we're going to actually run them separate for two years, is really what John has talked about. And with the appropriate lead generation and account executive linkage here, I think we can drive a lot more into the pipe for Quest, but the Quest team will be primarily focused on driving the software sales cycle force. And leveraging what we can from that 20,000 person sales force is a critical element of it.

KULBINDER GARCHA: Okay, great. I think that we're out of time. Thanks very much, Brian.

BRIAN GLADDEN: Thanks, Kulbinder. Thanks.

END