Dell Inc.

JP Morgan Tech Forum at CES

Steve Felice, President & Chief Commercial Officer

Michael Tatelman, VP & GM, North America Consumer

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MARK MOSKOWITZ: Okay, everyone. Welcome back from the break. And thanks again for participating in the Tenth Annual JP Morgan CES Tech Forum. I am Mark Moskowitz, the IT hardware analyst here at JP Morgan.

And we're pleased to have with us two executives from Dell today. We have Steve Felice, who recently was appointed to President and Chief Commercial Officer at Dell. So, congratulations on your new appointment.

STEVE FELICE: Thank you.

MARK MOSKOWITZ: And also Michael Tatelman from the retail marketing and channel operations division or focus. Did I get that right?

MICHAEL TATELMAN: No.

MARK MOSKOWITZ: Okay. Maybe you can correct everyone.

MICHAEL TATELMAN: North America Consumer.

MARK MOSKOWITZ: I remember it was very long at one time. You guys changed it. Consolidation is good.

Okay, so let's get started. I'm going to ask questions for about 15 to 20 minutes or so, and then we'll turn it over to the investor audience for more.

Maybe first, Steve, we could talk a little about your foresight, because a year ago you were on the stage here, and you were very confidence in conveying to investors that Dell was going to really benefit from your strategic turnaround, and that you were going to see some substantial operating margin expansion in the future. And obviously you were right because in the past year Dell has exhibited some very nice operating margin and gross margin trend lines. So maybe you could just remind investors, what were those key drivers, and how much headroom is there left in terms of the margin upside?

STEVE FELICE: Well, you know, the reason I was confident was because much of our business had operated in a way that derived a significant amount of profitability from our customers, and it was really where we were focused on adding value, bundling our services, the single point of contact that we have, and the combination of offering both an enterprise set of products, and a client set of products, all that customers value. What we said was we were going to start doing a few things.

One was, we were going to de-emphasize the areas that were purely volume driven, and especially in the low-end part of the product lines. And so we put that in place pretty successfully.

We also had tremendous advantages from all of the supply chain reinvention. So, I talked a lot about that last year, how we may have been behind, but we felt we had caught up in how to move the business from a pure build to order to also the ability to offer build to stock. For example, over a year ago, we virtually shipped nothing over the sea. And now every quarter we're shipping millions of units over the sea. That also enabled us to start to offer new things to customers who really cared about time-sensitive delivery. So, we implemented what we call Ships Fast, and we were able to get product to customers in 24 hours. So that also helped, and people were willing to pay a premium for that.

And so, as we continue to stick with the strategy of staying more focused on things that customers value with a great service model -- I think last year I told you that we did a couple of other things. We simplified the brands. On the consumer side, we went from six brands down to three. We also said we were going to dramatically improve the customer experience. We were able to do that as well. Our Net Promoter scores that we measure internally went up substantially.

So, this whole combination of offering value, and then expecting to get a higher margin for that has really materialized, and that's why I think we still have more room to go, because we're not completely finished with that. And we still think there's more pruning that we're finishing, which is getting rid of things that don't necessarily add a healthy profitable growth. And we're going to continue to rollout the strategy with some fantastic new products, one of which Michael has today with us.

MARK MOSKOWITZ: Michael, do you want to maybe talk about that new product?

MICHAEL TATELMAN: Yes. I mean, this is the -- I guess you guys will be the first to publicly see the new XPS flagship product, the XPS 13Z, and it's probably, we really believe, the best ultra-book product being released here at CES. Very thin, all aluminum, carbon fiber bottom, incredible design and construction, and an edge-to-edge glass screen that actually gives you a very large footprint in a small body. So, we think you'll be hearing a lot about this today after it's announced during the Intel keynote I guess any minute now, 4:30 this afternoon. So, we're real excited about it.

I'll pass it around if you want.

MARK MOSKOWITZ: Michael, how should we think about the target audience for these type of products, these ultra-books. Is it more of an enterprise type approach first, just given the higher price structure relative to some of the lower-end products that are out there in the PC market these days?

MICHAEL TATELMAN: Well, you know, anybody that's mobile from a mobile professional perspective, I mean, these aren't really that much more from when you think about professionals spending anywhere from the $800 to $1200 price point is still a very, very big market, both in the U.S. and globally. So, from a price point perspective, it's one thing.

But I also think that this product could, in some ways, act, if you're only going to carry one device, whether or not you'd really want to carry a tablet, or you'd want to carry this, particularly for folks like you that are heavy on input as well as consumption, this is a perfect product to slip in your bag and still be able to have the capability to input as well as consume data.

So, I think there's a very broad audience for it.

MARK MOSKOWITZ: And then a follow-up, in the months of November and December, some of your peers introduced their ultra-books with some pretty meager results. There wasn't that much customer traction. What do you feel the Dell XPS product offers that's maybe a differentiator that would kind of grease the skids in terms of customer adoption?

MICHAEL TATELMAN: Well, a couple of things. First of all, we've been on this design journey for several years. It's an investment that we made probably four or five years ago when we launched the consumer business. And that journey has taken us through a number of different iterations all the way up to this new thin and powerful line.

But, the initial ultra-book products were kind of, I would say, a little bit flimsy, where the technology -- and, by the way, this is the next generation Intel Ivy Bridge technology as well as the construction and capability. So they were a little bit flimsy coming out of the gate.

I think as you look at the construction of this product of the all aluminum body, the carbon fiber bottom, and people are going to see value even in the physical nature of it. And there's no compromise on power. So, the base configuration of this comes with a powerful Intel i5 processor with 128 gigs of SSD storage, and 4 gigabytes of RAM. A great service contract, it comes with a year of premium Skype for communications, mobile communications. So, it's really a full-featured product with a great service, and a great experience.

MARK MOSKOWITZ: Thanks, Michael.

Steve, let's revisit some of the discussion around the pruning that you mentioned earlier. I think a lot of folks, or investors, are waiting for the day when Dell has kind of lapped in the pruning, so you start having a better sales cadence, or growth cadence thereafter. Where is that inflection point? Is that going to be something we can talk about in calendar 2012, or is there still a lot more pruning to go here?

And a kind of follow-up to that is another question, this is probably more for Brian Gladden, but how much of the overall gross margin improvement has been driven by this pruning or smarter business practices? Is it more than 50 percent?

STEVE FELICE: Well, I haven't done the exact calculations. It's a lot less than 50 percent, because it's more affected the top line growth. It has helped profitability, but we're talking about we estimate -- I think we've put a number out there, about $3 billion of pruning in the last year. So, it had about a 5 percent impact on growth.

But, you know, on a $60 billion business, it's not going to have a severe impact on profitability. I think it's more what we did with the rest of the business, the other $57 billion, where we really focused on mixing up, you know, for example, the XPS growth in the consumer business is up 200 percent year over year, and it's now about 20 percent of our business. Now, we want that to be over half of our business, so we still have a ways to go to get that mix up, but we made tremendous progress in moving the consumer business from one that was focused on predominantly mid and low-priced bands to one that's now mid to high-price band focused.

On the storage side, as you know, we had to go through the wind down of the relationship with EMC. That's not quite finished yet, but we're well on our way. So, I do think that will completely go away during this coming calendar year that we're entering right now. There is some software and peripheral business that we're still winding down, mostly low margin software. And so there still has that to go.

I would say, you know, we're going to end that this year. We've been real careful to not say whether that's Q1, Q2, Q3, and I don't want to get that specific about it, because -- mainly because there's complications sometimes in how you manage relationships and how you scale these things down. And we want to make sure we're doing the right thing for the customer and not try to do something unnatural, just so we can hit projections. But, we're coming to the end of this. This calendar year we will be complete with that.

And I think the discipline that we've put into the business is one that our people are staying with. They don't view this as a campaign or a program. They understand now that this is a different way for Dell to operate, where we really focus on where we can add value to customers, and where we can extract a fair margin for that. That's why we continue to believe that the margin performance that we've gotten from the business is sustainable.

MARK MOSKOWITZ: Okay. Thanks for that color, and great job on that margin turn around. Maybe we could shift gears a little to the model and trying to understand how Dell's model is maybe different this time around versus the last global downturn. Can you help us understand, as Dell has tried to move more kind of to mid-tier markets, in terms of servicing more higher value solution sales, versus just commodity parts, is there a greater level of a kind of recurring revenues, or maybe revenues that are still higher priority for CIOs? So, if there is an environment of shrinking budgets over the next 12 months, maybe Dell this time around can absorb that macro-shock better than the last downturn.

STEVE FELICE: I think there are some things that are different and unique, and there are some things that are the same that still provide an advantage in a down market. The things that are different is that we're not chasing volume to make up for last year's growth. So, that's a clear difference in our strategy and one that we've been disciplined now for well over a year. So, that certainly helps, and we're not trying to sustain a growth rate by putting low margin things out there.

So, I think for example, if you look at this whole year, you have tampered down growth due to economic conditions, bug with all this pruning and all this shift in strategy, we were still able to hold our revenue and yet dramatically improve our profit. That puts less pressure on next year, which no one knows for sure when the economy is going to turn, but even in a relatively down market we have less pressure now, because we're growing off a healthier base of business.

The mid-market focus that we have I think is a big plus for us. This customer set is very conscious about efficiency and effectiveness and increasing productivity. The offers that we have in the marketplace, especially on the enterprise side, really fuel that strategy. We feel absolutely fantastic about the 12G server line that we're coming out with in this first quarter. We think it's by far and away the best price performance offering out there and it will definitely cause companies to think about their IT strategies and how to get greater productivity expansion. The storage products we have out there we think are competing extraordinarily well now. So, we've broadened that IP portfolio dramatically between Compellent and the continued growth of EqualLogic and then the addition of new Force 10 networking. So, another big change from previous downturns is that we have a lot more IP, we have a lot more things that have embedded margin protection, because we own the software content that is sitting in there.

The thing that stays the same that I think has benefited us in a down market is the overall value proposition that Dell has always offered, which is that you can do more with less, you don't have to use proprietary environments. We think the technology environment is moving even further in our favor, where you can continue to use a scale-out strategy and not make heavy investments in proprietary environments like an MVS or a UNIX operating environment. So, I think that's where we're getting continued interest from customers. So, between the expanded portfolio and the improved discipline I think that's why we're poised to be able to handle these kinds of conditions better than in the past.

MARK MOSKOWITZ: Okay. Thank you. And speaking of the expanded portfolio, maybe we can talk about the acquisition strategy. Dell seems to really put together a good string here of acquisitions that have not frightened investors. I know Perot Systems seemed to kind of spook some investors, but since then you guys have done a real nice job of putting together a good string of acquisitions here. Can you walk us through kind of the criteria that Dell employs in terms of evaluating these companies?

STEVE FELICE: Yes, you know, we have an overarching strategy that we spend quite a bit of time on, where we look at customer requirements and we prioritize the needs, based on what they want. I think I covered some of this a year ago when I talked about from the small business standpoint, how we said systems management and information management and security were key requirements, and in the past year you've seen us act on that, like with the acquisition of SecureWorks. Cloud integration has become a really big need for the mid-sized company. What I mean by that is, as companies adopt cloud computing they run into a new difficulty, which is how do I integrate the data from one application to another. That's why we acquired Boomi. And then we since have lost Dell cloud business applications in the last six months, which now offers a platform for customers in the small and medium space to build out an application environment, but still have -- make it look like one integrated package, where you have single sign-on, you have security, you have a common dashboard to look at your operating metrics. But, you could be using multiple applications in order to do that, as opposed to a small business feeling like they have to buy a very heavy package, like an SAP-type package, which they typically can't afford to do.

So, the underpinnings of our strategy are based on what we see as customer needs. We still prioritize things like information management, security, as some of the highest priorities, things that enable interoperability. Things that make multiple systems work better together. So, you've seen us make investments in things like Scalant, which helps us manage the overall architecture for a customer. So, we're still very infrastructure-focused, and we're still very much into acquiring IP that lives up with our principles of being scalable and open friendly, but gives great efficiencies to customers. And that's what we're going to continue on in this coming year.

MARK MOSKOWITZ: As a follow-up, you mentioned security and we keep hearing about security, security, security when we do our CIO surveys, is that an area where we could see maybe Dell become more active from an acquisitive perspective? I know you partnered, made some acquisitions, this seems like you could still maybe build out a bigger kind of oversight there.

STEVE FELICE: You could see us more active here. Even in our own internal development. The KACE product, for example, has some phenomenal security applications embedded in it, which we have started to offer more broadly to customers. So, security is definitely something that remains a high interest. You could see us develop more. You could see us acquire more in this space.

MARK MOSKOWITZ: And then looking at investments in IP from a different angle, maybe could you talk a little about where Dell is, maybe just broadly speaking, or even from the SMB, or the consumer perspective, from an R&D perspective. I know there's been talk over the past year, where you do have IP, or where you are more high value, that you're going to spend more on R&D, maybe even more on sales and marketing than historically -- so, how should investors think about it? Are there examples maybe with Compellent, or EqualLogic? I know you guys have done a great job in terms of integrating all those assets to make a really good storage platform, and the market share wins. Gartner in the past couple of quarters shows that, but can you maybe just help investors understand what Dell can do internally, as well, besides just making acquisitions?

STEVE FELICE: Well, I think in general the best way to demonstrate what we do is that when we acquire these companies that are more heavily R&D focused, they have a certain percentage of their revenue that they're spending on R&D, and that percentage -- I'm not exactly right here, but ballpark it, it seems to go in the range of 10 to 17 percent of revenue is what is on R&D. And right off the bat, I'll tell you that we sustain those percentages when we acquire these companies. So, we're spending 10-plus percent on continuing investment in R&D into these various businesses to make sure that we're continuing to add to the portfolio. So, whether it's KACE or Compellent or Boomi or SecureWorks, they continue to have a roadmap from the time before we acquired them where they're investing. We've added hundreds of engineers to these businesses just in the last year.

On the sales and marketing front, we talked during the year about adding capacity and capability in the sales force. And we've added thousands of people during the year that are capable of selling solutions, more specialized, that can talk about architectures, and can sell servers and storage in a more complex environment.

And what we said towards the middle of the year was, we will now start focusing on getting a return on that investment, and that's really what this coming year is all about. We now feel like we have a capable force that can continue to grow our enterprise business in a very healthy way. So, we have plenty of capacity, and now we're going to start getting the productivity out of that.

MARK MOSKOWITZ: Thanks for that overview. I've almost taken up all my time, so I'll ask one more question, and we'll shift it over to Michael, and then we'll open up to the investor audience.

Michael, can you just talk a little about what has changed with respect to Dell's retail or consumer strategy or go to market over the past year, because obviously your profitability has improved, and how you're targeting different customers has improved. But just give investors here a sense of, what have you done, and what can still be done, because I think folks are really expecting a little more out of that business still?

MICHAEL TATELMAN: First of all, I mean, it always starts with great products. And I think as we pass around the new XPS ultra-book, you'll see that the investments we've made, we have a much stronger portfolio than we ever had in the past. And that's across the board from portable mobility all the way through to desktops and our premier gaming line of Alienware, where we're bringing out some of the most powerful products we've ever done in the past.

But also, from an operational perspective, there's a significant amount of change that we've made to how we run the business as it pertains to all of the efficiencies garnered from a more consumer product type infrastructure than the technology infrastructure that we built in our build to order business over the last 20 years.

As Steve mentioned, we now ship millions of computers on the water every quarter. We have a much more disciplined, seasonal focus on product refreshes, which ties together the product development organizations all the way to logistics, which, again, enables us to gain efficiencies in the products.

We've reduced the number of SKUs and configurations that we sell, both enabling an easier choice for customers, but also generating the ability to get more efficiency out of our development and R&D process.

And then, where the rubber meets the road from a channel perspective, we have a pretty sophisticated multi-channel footprint today that I would say is stronger than it was in the past. I mean, over 500 million people in 160 countries around the world still come to Dell.com to get technology to fit their needs. I mean, it's one of the most unique capabilities from a scale perspective of any company in the world, both in its reach and its capability. And it's not just the online capability of Dell.com, but it's also the ability, if you're a small office, for example, to get consulting on the phone by an expert on how to kit up file sharing, or security, or cloud-based infrastructure for your small office, which is a unique capability.

We've added on top of that, of course, over 50,000 points of presence from a retail perspective around the world on the consumer side. And then, you know, we're number one in customer satisfaction right now from a reseller perspective on the VAR side. So, we have a very significant global, multi-channel footprint that we've built over the last four years that's a very, very different Dell than what it looked like four years ago.

And then, the underlying processes, and business management system to be able to scale and optimize that channel from a logistics perspective, tremendous up-side opportunity to continue to scale that both in new geographies around the world as they mature and grow, but also to reap some of the capabilities that we've invested in technology and systems to optimize that footprint.

MARK MOSKOWITZ: Thanks for that overview. I guess as a follow-up, clearly a lot more refined structure, but it seems like you're a lot more nimble, too. Is that really a requisite now as you mentioned some of these geographies where you have to have different, maybe, pricing strategies, or form factors where one form factor doesn't work in one region versus the other?

MICHAEL TATELMAN: We've added a capability around merchandizing and offer development, where we have a planning function now that's global so you can still get the scale, because it's probably 15/85 more than -- it's that 15 percent of nuance in the products, or in the distribution, or in the marketing messaging that really makes a difference in India versus China, or Vietnam versus Indonesia. So, we have that capability today that we didn't have in the past, and that does give us some nimbleness.

A common example would be that the most popular notebook screen size in the United States is 15 inches, in China it's 14. So, and it's a little bit different now that things are in HD, but we caught that trend early in our merchandizing groups, and developed a line of 14-inch notebooks for Asia several years ago that gave us the ability to leap to a number two position in China. So, those are the kinds of things that we're able to do today with the intelligence on the ground, the channel partners, and the merchandizing capability that we've added to the business.

MARK MOSKOWITZ: Okay, great.

Let's open it up to the floor. We have a question in the back, and if you guys could repeat the question, too, for the webcast, that would be great.

QUESTION: (Off microphone)

STEVE FELICE: Sure. I don't think I'll tell you anything you probably haven't heard from everybody else; with the one exception that I think our team has done a fantastic job of managing this. We've been able to weather the storm pretty well. And we said we would, because we had strategic relationships in place for a number of years, and I feel good about the way we've handled this. We've certainly had to manage different sizes of drives, and that's caused some demand shifts, but being a direct company, with still a lot of our business built to order, we probably were in the best position to do that.

I think these next few months are probably the highest levels of uncertainty in the overall industry, just because you're now coming off this fourth quarter where you had product in the channel and you're now entering a few months where full production hasn't started up yet, and so you clearly have shortages that are getting allocated. So, I think production, as I understand it, is supposed to start resuming in the March timeframe. We all -- I think we believe that this will take a full year to work itself out. But, if I just look at Dell we continue to feel good about how we've been managing this, how we're positioned, and we feel like we have at this point in time enough supply to meet the demand.

QUESTION: (Off microphone)

STEVE FELICE: You know, in some respects the server market has some characteristics similar to the PC market, and what we've been focusing on is you can sell a $500 server, you can sell a $5000 server, you can sell a $50,000 server. There are now competitors out there that want to be number one in share, and they'll maximize the sale of tower servers, or very low-end blades. And our view is, we want to grow the revenue and the profit of the servers, which we've been doing much more so than focus on unit share.

So, you'll see us talk much more about what's the revenue growth, what's the profit growth. We want to sell into the high workloads that servers are used in. So, I think we're spending less and less time looking at unit share and much more time looking at the overall financial performances of these products.

QUESTION: (Off microphone)

STEVE FELICE: Well, I think there's still margin expansion there, because we're starting to move up the stack into the kinds of solutions we're getting involved in, and with the 12G product we believe we're going to continue to move into mission critical spaces, which will have margin expansion capability that has higher-end services that go with it. So, I don't have an exact number to give you, but we certainly think there's room for additional margin expansion in servers.

QUESTION: (Off microphone)

STEVE FELICE: I really can't. I shy away from doing that, because you get into things like the mix and the geographic splits and all that, and I haven't done the calculations, so honestly we just think we -- we just think there's expansion there. I don't know what the exact number is.

QUESTION: (Off microphone)

MICHAEL TATELMAN: So, on the sea shipments, I'm not going to give you an overall percent, but we're hitting our numbers and looking to get into the at least three-quarters, at least 70 percent to 75 percent of the available units that we can ship on the ocean. So, it's not every product launch there's timing issues, there's other things, so we're in the millions of units and I can't give you the exact percentage of overall shipment, but there is significant headroom, because not everything that we have in the world is available for ocean ship yet. So, there's geographies that haven't been turned on pretty much wholesale. And there are certain products that we haven't put the infrastructure in yet. So, from that perspective there is upside.

The unit that we're passing around is $1000, $995 for, as I said before, a Core i5 Intel processor with a 128 gig hard disk drive -- I mean, SSD drive, and four gigs of RAM, plus the best service protection in the industry, a year of premium Skype, and you can go online later today and reserve one.

STEVE FELICE: So, I think that -- correct me if I'm wrong, Michael, but that configuration will compare very favorably with a $1299 product from Apple, and yet when you go through and look at the size, you basically have a 13-inch screen and a 11 inch body, because it's edge to edge. And the performance is going to be great, the construction, we think, is of a higher quality. But, we think this product is going to compare extremely well. And then you can go up to Core i7 and you can get to 256 on the SSD. So, you can get a very powerful product out of that small form factor.

QUESTION: (Off microphone)

STEVE FELICE: You know, I think that's already a strength of Dell. And I think that's where we have a big competitive advantage. And the best evidence of that is, in the small/medium business space, when we did the Compellent acquisition this year, it only took us one quarter in the SMB space to replace the lost EMC revenue in total dollars, one quarter.

Now, the large enterprise space, we're still going through it, and that's logical because they go through evaluation processes, and it's a much more rigorous process. But to prove the trusted advisor status that we have in the SMB space, we simply have to tell the customer this is what we recommend, and the majority of the time they're going with us. That's why KACE did so well. That is exactly what we are trying to accomplish in the SMB space is to be the single point of contact, and the trusted advisor.

And that's why we feel we can move into the application space in the SMB world as well. And that's why we bought Boomi, and I think you'll see us continue to push in that mid-market design focus, which if you take the whole mid-market, it's still the largest buying technology segment in the world. Everyone wants to always talk about the very high-end, but it's really the mid-market where most of the market share is. And I like our chances a lot with that design point.

MARK MOSKOWITZ: We have about time for one more question.

QUESTION: (Off microphone)

STEVE FELICE: I'm sorry, I didn't hear.

MICHAEL TATELMAN: On the HDD price increases, do we have a plan to raise prices on our storage.

STEVE FELICE: When there have been shortages, and the costs have gone up to us, we've passed that on. We've already been doing that, and I think most of the industry has been doing that. Now, there have been other components that have come down. So, it doesn't always mean that the model price will go up. But, we've been making sure that we're not taking a hit because hard drive prices might be going up as a component.

There is one other key point that I want to make, if I can, related to the XPS line, because we didn't really touch on this. The differentiation between us, for example, and Apple as we move into this thin and powerful product line, our commercial base is increasingly telling us that they want employees to take a more active role in choosing the technology that they want. And we all refer to this as the consumerization of IT. And we certainly see that.

The unique thing about this XPS line, including the product that we're announcing today is, we're bundling in now pro support and custom factory software integration. These are really important points because this will enable businesses to allow their employees to use these kinds of products but yet still have a safe and secure and managed environment. Whereas, if you look at Apple, and the feedback we get from a lot of CIOs is, they say, I have an unmanageable environment. My customers want to use this product. My employees want to use this product, but I have a hard time supporting it.

So, I think we're taking a pretty unique position here in how we approach this thin and powerful product line where you're going to see us be very favorably received by the corporate side that's seeing the consumer side of their employee base want a beautiful product, but them being able to support it.

MARK MOSKOWITZ: Well, thank you Steve Felice, and Michael Tatelman, appreciate it.

STEVE FELICE: Thanks.

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