Dell to Acquire Force10 Networks
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Operator: Good morning, and welcome to the Dell Inc. and Force10 Networks Conference Call. I'd like to inform all participants that this call is being recorded at the request of Dell. This broadcast is the copyrighted property of Dell, Inc. Any rebroadcast of this information in whole or part without the prior written permission of Dell Inc. is prohibited.

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I'd like to turn the call over to David Mehok, Executive Director of Investor Relations. Mr. Mehok, you may begin.

David Mehok: Thank you, Christy. Good morning, and thanks for joining us. We're pleased to announce that Dell and Force10 Networks have reached a definitive agreement for Dell to acquire Force10. On the call with me today are Brad Anderson, Senior Vice President of Dell's Enterprise Solutions Group, Dave Johnson, Senior Vice President, Dell Corporate Strategy, Dario Zamarian, Vice President and General Manager of Dell's Networking Business, and Henry Wasik, CEO of Force10.

We have posted our web deck on dell.com. I encourage you to review these materials for additional perspective.

Next, I'd 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 our website. We assume no obligation to update our forward-looking statements.

Now, I would like to turn it over to Dave.

Dave Johnson: Thanks very much, Dave. Good morning, and thanks, everyone, for joining us today. If you'll move to slide three, you know, you'll see a summary of our strategy. As we reviewed at our analyst meeting in Austin, we continue to execute our strategy, develop and deliver open, capable and affordable solutions for the enterprise. It's a strategy based on differentiated solutions with a design point to the mid market, investment in IP and investments in our systems, processes and people. We're locked on this strategy, making great progress, and we're delivering solid results.

Today's Network announcement is an important next step to broaden our enterprise portfolio and to offer our customers a complete range of data center solutions.

The industry is at an inflection point. The data center is becoming more central to application and information delivery as we see a trend toward convergence of compute, storage and network resources.

There's an explosion in data, which is stressing historical methods for storing, managing and analyzing that data. And there's the ever increasing cost pressure on IT departments requiring them to standardize, simplify and automate in order to fully deliver the productivity potential of IT solutions.

Given these trends, this is an ideal time for Dell to invest in Force10 to achieve a combination of performance leadership, architectural efficiency and system level integration.

If you'd move with me to slide four for a minute, let me give you some of the details of this transaction. As I mentioned, Force10 is a leader in high performance data center networking. It's really a terrific fit for Dell, both operationally and culturally.

Dell takes an open and integrated approach to data center solutions. Similarly, Force10 solutions support open standard based systems and management tools. They provide enterprise performance and resiliency while reducing overall cost of ownership and simplifying network deployment.

Force10 is approximately a $200 million revenue company on a trailing 12 month basis with approximately 80 percent of their business today in North America, but operating in over 60 countries. A vast majority of their revenue is in the data center networking segment. Force10 has approximately 750 employees with most of the employees residing in their headquarters in San Jose, California or in the large research and development center in Shinai, India. They have more than 1,400 customers currently using their technology and solutions.

The transaction has been approved by the board of directors of both companies, and we're anticipating closing to occur later this summer, subject to the customary closing items.

We have a strong track record of integrating and driving value from acquisitions of this size and scope, which we consider to be the sweet spot for us. Based on our experience with similar acquisitions, we expect this transaction to be accretive to earnings on a non-GAAP basis in the second half of next year, which is our fiscal year '13.

The combination of Dell and Force10 will allow us to leverage Dell's brand, its strong distribution network and very large customer base to accelerate adoption of their leading technology.

We're really excited about welcoming Force10 to the Dell family. We're even more excited about the opportunity to help our customers and dramatically expand the business.

With that, I'd like to turn it over to you, Brad.

Brad Anderson: Thank you, Dave, and good morning, everyone. First of all, I'd like to reiterate Dave's enthusiasm for this transaction. This acquisition is very consistent with what we have been saying for more than a year and as recently as our last month's analyst meeting about developing or acquiring Dell IP to facilitate the execution of our strategic enterprise objectives, one, positioning us favorly in high growth areas of the business, two, enhancing – and enhancing our enterprise profitability.

Most recently, we've been very successful doing just that in the storage arena. When you think about the next generation computing and intelligent data management, networking is the next key piece of the puzzle for us to execute on. The acquisition of Force10 greatly enhances the breadth of our solutions and provides us those kinds of data center solutions that our customers are asking for.

What I'd like to do is introduce to you Dario Zamarian. Dario leads our networking business within Dell. He'll lead this combined entity. And I'm going to ask Dario to kind of discuss in more detail the important role of Force10 in Dell's networking strategy. Dario?

Dario Zamarian: Thank you, Brad, and good morning, everyone. Well, Dave already pointed out that Dell has an ongoing strategy focus on delivering complete data center solutions. In fact, we've been executing the strategy, and today's announcement on our intent to acquire Force10, we are taking the next logical step in pursuing the industry best solutions offering for the data center.

Dell believes the data center is the center connecting point for users to the information they need to run their business, simple as that. Whether data center architecture is a traditional data center or a cloud environment,

users now demand access to their data and applications any time, anywhere.

So, if you move with me to slide number five, I'd now like to spend a few minutes to highlight the direction we are taking with respect to our network strategy. So, let's begin with a few thoughts around the customer key plans.

End user experience accessing information is based upon the ability to fluently traverse multiple networks and for infrastructure to deliver that application for information is critical. And we know that, these days, it needs to be irregardless of location and end point devices.

We believe the data center is the focal point and may be transformed into a streamlined, efficient and policy driven network that is responsive to change applications and end user demands. A more heterogeneous group of end users on more devices, in more locations accessing more applications and generating more data is not a futuristic view. We all know it's happening today.

The end user consumption models are constantly changing, as well. And it all requires ever-growing network capacity and flexibility.

This is all transpiring behind the backdrop of many CXOs having to reduce operating expenses. To accomplish this, they need new tools to provide greater insight and experience you're making with the organization. Simply put, the end users' IT staff and CXOs all need a new approach for a data center, and of course, its underlying network.

These needs are driving unprecedented growth in the data center segment. The numbers, in fact, at the bottom of slide five will illustrate that kind of growth we are expecting. The overall networking market was approximately $32 billion last year on an overall topologies of data center, campus and branch. Specifically, data center accounts for about $6 billion. And by 2015, the data center business is expected to go to a compounded annual rate of 21 percent to approximately $16 billion, much faster than the approximately 3 percent for the networking industry.

On slide number six, we'll show what Dell differentiated view is for the data center. We want to make sure that we can manage data and we can deliver a different network environment. In fact, we call this point of view a virtual network services infrastructure, abbreviated VNSI.

We all know how quickly the change in the networks are happening. The virtual network service infrastructure enables the following properties, the following business benefits - one, a simpler, more open networking environment that is easier to view, manage and control and one that can scale for requirements today into the future.

So, let's talk about some of the tenets of this vision, the VNSI vision. The first tenet, the first idea is around managing from the edge. In this context, the edge refers to the servers and the (storers) that touch the network in the data center. The edge is where the applications are, so logically, we believe is where the intelligence ought to reside in the data center.

As applications are virtualized and consolidated for optimal performance, bi-networking policies to applications optimized networks, scalability and management. While we all know that this needs to be done, not manually, not through administrator intervention, but highly automated so that the administrators can pay attention more and more to their applications and less to their underlying infrastructure.

But, we also believe the networks need to be flatter. Networks have been built to a traditional three tier architecture for decades with static topologies and configurations frankly getting in the way of modern data center requirements.

With advances in wire speed switches, silicon, merchant silicon, poor densities and significant improvement in power consumption and of course increasing option within standards, we can now architect and deploy high performance topologies ready for the virtualization and mobility changes in the data center.

The third tenet is about scaling virtualization. Server and application virtualization places meaning new demands in the network - simply put, we believe the network must enable virtual machine life cycle management that enable the scaling all the way from initial deployment of a virtual machine to its decommissioning.

So, these are the ingredients of what we think is a differentiated unique Dell's virtual network services infrastructure point of view. So now, with that in mind, let's go to slide number seven and let's take a slightly deeper look at the Force10 acquisition that bring – what that brings to our vision.

To think about the history of Force10, it's a history of innovation and technology leadership in the data center networking in particular and is very much complementary in aligning to our virtual network services infrastructure.

In fact, if you think about the Force10 Z-Series family of switches in particular, that family is redefining the economics of price performance to very dense and high performance switches combined with very low power consumption and lower cost. This platform we believe enable lean scaling of big data center while providing an industry first design, particularly appealing to our strategy of the mid market customer.

The normative S-Series, also know as the Top of Rack switches, has the ability to host third party applications, and of course, by doing that, you can announce the networking services such as firewall, load balancing, and they are all integrated with the top of rack switch. These fully featured switches provide state of the art, low latency, and therefore, helping demanding applications.

The E Series is a model chassis support – the model of chassis E Series is for the mission critical applications listed at the core of the data center, and they allow for network availability, agility and efficiency for power and cooling costs.

Let me proceed to point out that Force10 has an open modular network and operating system that's referred to FTOS Force10 operating system, is a stable, resilient and extensible software platform, which provides common management functionality in a common user interface across product lines. It supports policy driven automation with capabilities as we have highlighted here in the bottom part of the slide.

We are very, very encouraged by an increased breadth of the portfolio of our networking product line and Force10 is a complementary product to our PowerConnect line for the campus switching market. We believe that Force10 brings the real technology in the data center.

Now, I want to leave you with two thoughts. The first one is that the data center networking is going through a significant transformation to meet the needs of the end user, the applications, virtualization and the IT administrators, of course. It is a rapidly growing market that aligns with Dell's enterprise and the mid market strategy that we have.

Dell with VNSI, the virtual network storage infrastructure, has developed a differentiated point of view, and we believe that Force10 with its industry leading products and technologies, of course, will have a great complement to existing Dell enterprise data center solutions.

With that, I'd like to give it – turn it over to Henry.

Henry Wasik: Thank you, Dario. I am excited about becoming part of the Dell team, and the entire team at Force10 is excited to be an integral part of enabling Dell's virtual network services infrastructure vision.

This agreement is great for Force10 and great for our customers. We have been focused on fundamentally changing the economics of data center networking, which aligns very well with Dell's history of changing the economics of technology for customers.

Dell and Force10 share a common vision for enterprise data center networking. We are committed to delivering differentiated IP to our customers with world class service, support and value.

Force10 and Dell have a similar approach to product architecture and open systems. We are both committed to delivering a converged data center solution that is open, scaleable and affordable.

With this powerful combination, Dell brings Force10 technology to the global markets from a world class sales and marketing organization and recognition of the Dell brand. Dell's enterprise solutions group continues to execute its data center vision, and now networking is an integral enabler of application and intelligent data management delivery for our customers.

As Dario has discussed, Dell's virtual network services infrastructure connects users to their data center applications and data, regardless of device or location, in an efficient, policy driven computing fabric now enabled by Force10. Force10 serves key markets with bandwidth intensive data center solutions including Web 2.0, social networking, online gaming, cloud and hosting providers and super computing applications that require the support of high performance, resilient and scaleable network infrastructure.

It is very exciting to think through the possibilities that exist when partnering our technologies and experience in the networking business with Dell's capabilities, reach and complementary strategy. Thank you, and I will hand it back to David.

David Mehok: Thanks, Henry. Now, let's open it up for questions with Dave, Brad, Dario and Henry. As a reminder, please limit your questions to one with a follow up. Christy?

Operator: Your first question comes from the line of Benjamin Reitzes with Barclays Capital.

Ben Reitzes: Yes, Dave, can you guys talk about how you're going to manage the OEM revenue that Force10 has and what your estimates are for loss of OEM revenue going forward?

Dave Johnson: About half of their revenue went through distribution partners, and the other half is direct. We're not anticipating a material change in their organic revenue flows.

Brad Anderson: Yes, let me just add to that. You used the word – Ben used the word OEM. Force10 is principally selling to end users. And we're absolutely going to embrace the channel much like our storage acquisitions, Compellent being the most recent one where much of their volume went through the channel. We see this as a big opportunity to expand and develop a much more robust networking channel within Dell.

And then, clearly, direct is, you know – we have a long history of direct. And it's our principal route to market. And so, we're going to obviously invest heavily to expand the direct market, as well.

Ben Reitzes: OK. And then, just with – my follow up with regard to margins - you know, I haven't had time to run the numbers, but it looks like gross margin in the 46 percent range. I think that's right. And, you know, are you looking at maintaining that margin, or do you think you'll reinvest in price to gain share now that you're part of Dell, and given that Dell's gross margins are only 23 percent-ish? Do you have the opportunity to lower that margin in order to be aggressive?

David Mehok: Yes, hey, Ben, it's David. I'll answer that. You know, the key focal point here is obviously the point that Dave made earlier, which is the plan for this is to be accretive to non-GAAP earnings by the end of second half FY '13. We're not going to parse it out exactly how we get there between some R&D investments and margin contraction or expansion. But, obviously, as we continue to migrate through this, we're going to make sure that we're focusing on that key focal point.

Dave Johnson: Yes, and let me just add one thing. We think Force10 has terrific IP. They're a leader in Top of Rack and 10 gig technology, much like our past acquisitions. We're very much focused in companies bringing outstanding IP and leadership in their segment, and we think Force10's another one. And so, with leadership, we think there's margin expansion opportunities.

Ben Reitzes: Thanks, guys.

David Mehok: Thanks, Ben.

Operator: Next question comes from the line of Jayson Noland with Baird.

Jayson Noland: OK, thank you. Henry, maybe an update on success with new products - that's been the story recently, the Z9000, and if you can talk about just recent trends there.

Henry Wasik: Sure, sure, great question. You know, many of you were at Interop where we had a major announcement of open cloud networking, and we did have all of the new products on display there. The energy and the reception at the show was tremendous, and the customer attraction has been substantial since that time, particularly around the Z series.

We see that as fundamentally changing the way people build networks. And there are many trials underway. We've already begun and had successful sales of the product already. And we are seeing people relooking at their network architecture.

So, what's also quite interesting about the Z Series that you have to stand back a little bit in that due to the nature of the product, if you look at, you know, the history of compute and the analogies there and compare that to switching, that the Z Series fits as an enterprise product if you think about it as replacing chassis with huge advances in cost, power and density, as Dario just mentioned.

Number two, for the large web properties, it's a cell based architecture that gives you a linear scaling, a much more resilient fabric in terms of building huge scale out networks. So, it really is a shift in the foundation of how people are going to build networks going forward at large scale and also radically changes the economics of the enterprise. So, the uptake has been quite encouraging.

Jayson Noland: OK, thank you. And a follow up question for the Dell team on go to market - Force10's seen success at the high end of the market with some very high

profile Web 2.0 properties, and Dell's success is more mid enterprise. You guys have relationships with Juniper and Brocade in switching. So, how should we think about all of this fitting together going forward?

David Mehok: Dario, do you want to answer?

Brad Anderson: Well, let me make a couple of comments, and I'll ask Dario to further elaborate. Clearly, we see this as a big opportunity to expand. We've been quite transparent in that we want a broad mid market design point. We see the technology fitting that quite well. They have had success in the high end. We will obviously want to continue that.

Much of the same properties they're selling into the high end are also Dell properties through our DCS business. But, we think this is a fantastic technology for a mid market design point and for a really broad market reach, and that will be our focus.

Dario Zamarian: Yes, in fact, Brad, to add to that, we're really pleased about the anticipation that Force10 did about a year ago when they put in motion the design principals for the Z9000, and for that matter, even the S7000, one of the Top of Racks, which is, we believe, that's going to be resonating quite well with the mid market that we have in place for all the properties that Henry mentioned.

Jayson Noland: Thank you.

Henry Wasik: Right. And this is Henry. So, just one more on that to the mid market design point - so, you know, we have – as a company, we've displaced sales of Cisco Nexus even with our 4810, which was in the S Series class that Dario mentioned, which is a single form factor of a stackable product because the economics are just overwhelming. So, if you – again, you have to stand back and look at our product set in a way of, OK, this technology and the richness of FTOS and the future capabilities for enterprise are quite extensive. Even though Force10 didn't historically promote that publicly as much, all the functionality is there, though. So, you know, these things really do fit the mid market design point quite well today.

Jayson Noland: Thank you.

Operator: Our next question comes from the line of Toni Sacconaghi with Sanford
                    Bernstein.

Toni Sacconaghi: Yes, I was wondering if you could describe the terms of the deal,
                    specifically the price paid and whether this will be all cash.

David Mehok: Yes, Toni, we're actually not disclosing the terms of the deal.

Toni Sacconaghi: I was wondering if you could also comment on whether Force10 is
                    currently profitable – your guidance certainly brings that into question in
                    terms of its accretive nature – and whether you can talk about trailing 12
                    month growth and trailing two year growth rate.

David Mehok: So, from a margin standpoint, we're not breaking out the historic
                    profitability. We can – you can talk – Henry, if you want to talk high level
                    about some of the growth trends that you've seen trajectories in the
                    business that would be probably helpful.

Henry Wasik: Yes. Well – yes. So, the S-1 is on file, and a lot of the historical data is in
                    there. And, it's probably better to go back and rely on that rather than
                    trying to recite too many statistics now.

                    Our data center growth year-over-year last quarter was extremely high.
                    And, part of that obviously changes in transition in the industry, and
                    secondly, the effect of the new products that we've introduced in the past
                    six months really beginning to kick in. So, I guess I would refer everyone
                    back to the data in the S-1 is quite extensive.

Operator: Your next question comes from the line of Richard Gardner with Citi.

John Slack: Hi. Actually, this is John Slack from Citi. You know, Force10 had a pretty
                    big carrier oriented business on the transport side. I'm wondering what
                    Dell's plans are on the transport side there.

David Mehok: Dario, you want to address that?

Dario Zamarian: Yes, I'll address that, John. You know, you're absolutely right. There's been a transformation that Force10 has initiated a number of years back. If you think about Force10 transfer along with Ethernet portfolio are well established among many service provider customers, right? So, we continue to service the inter data center and the one carrier network market.

It won't be our primary focus, but by definition, we're going to help the customers continue. And of course, we have a very extensive portfolio of solutions at Dell that we'll be looking into leveraging.

John Slack: Great. Thanks a lot.

Operator: Your next question comes from the line of Brian Alexander with Raymond James.

Brian Alexander: Yes, just a follow up - I know you're not disclosing the terms of the deal, but I was just wondering why. Is that because the price is immaterial? And could you remind us what that threshold is, or is there a different reason for not disclosing the terms? And then, I have a follow up.

David Mehok: Well, Brian, it's a private transaction, number one. And so, we've determined that this was one that – it's not based necessarily on materiality thresholds, but it's something that obviously we're looking at. But, it's not something that we're prepared to disclose at this time. And, again, you saw that the preparation for closing is in the next one to one and half months is when we plan on closing this from a timing standpoint.

Brian Alexander: OK, fair enough. And then, just on channel conflict potentially, is there a concern that some of Dell's existing channel partners on the storage side may have been offering competing networking offerings, and that there could be some potential conflict with Force10's channel, or is that really not an issue here? Just talk maybe a little bit about the channel overlap that you have.

Brad Anderson: Yes, let me talk to it briefly is that, Force10 obviously has a very robust channel. Dell has developed, again, a robust channel moving our, particularly our storage products, but our server products, as well.

You know, we don't see this as a conflict. As we build our channel partner network out, they are asking us for putting more products and more complete solutions into their portfolio. And so, we see this again as an opportunity or catalyst for us to significantly expand our networking presence in our existing channel and to grow the channel with all the partners that Force10 brings to us.

Brian Alexander: Could you just quantify what overlap you see today between your partners and theirs.

Brad Anderson: Yes. Today, as far as Dell shipping PowerConnect through the channel, it's relatively a small number. So, it's almost de minimus.

Brian Alexander: Alright. Thanks.

Operator: We'll now take our final question from Katy Huberty with Morgan Stanley.

Katy Huberty: Thanks. Dell, you've talked about more aggressive hiring of sales specialists, and I know some of those have been in the networking space. With the addition of the Force10 sales force, is the build out of the sales force in this area complete, or do you expect to step up hiring from here?

Dave Johnson: I'll address that one for you. Consistent with our policy on many of our acquisitions, it's really the post acquisition growth that delivers both value for the shareholder and for our customers. And so, our practice - and I believe it will be consistent here - is to substantially grow the assets of the acquired company.

So, we will leverage this as a core along with our existing resources. But, I think you can expand that we'll expand them.

Brad Anderson: Yes, and maybe let me add just one other comment, too, is that we have been on the Dell side prior to this, as you had mentioned, Katy, building out our specialist network inclusive of networking and doing it globally. And

so, Force10 obviously gives us a big shot in the arm. They bring a significant sales capability, both channel and direct.

But, a lot of that capability is in North America. And so, now that we have a fantastic product set in the F10 products, you know, we're going to obviously want to accelerate the build out internationally because we've got products we want to put into a global distribution system. And so, you're going to see us continue to – continue our hiring practices.

Katy Huberty: OK. And then, just a quick follow up for, I think, David - I know you mentioned the deal would be accretive in the second half of next fiscal year. Is there any quantification you can give us as to how much of a drag it is on earnings in the next couple of quarters.

David Mehok: Yes, I don't think you'll get any change in the guidance that we've previously given for this year.

Katy Huberty: OK, great.

David Mehok: Yes. Well, thanks, everyone, for participating today. We look forward to talking with all of you in much greater detail after the close of this transaction. Have a good day.

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

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