On June 10, 2010, Dell issued a press release announcing that, as a result of ongoing discussions with the U.S. Securities and Exchange Commission, Dell has revised the financial results that were reported on May 20, 2010, to record a $100 million liability related to the potential settlement of the previously reported SEC investigation.

Dell Inc.
First Quarter Fiscal Year 2011
Earnings Conference Call
May 20, 2010
4:00 – 5:00 pm CT

Operator: Good afternoon and welcome to the Dell, Inc. First Quarter Fiscal Year 2011 Earnings Conference Call.

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As a reminder, Dell is also simulcasting this presentation with slides at www.dell.com/investor. Later, we will conduct a question-and-answer session. If you have a question, simply press star then one on your telephone keypad at anytime during the presentation.

I'd like to turn the call over to Rob Williams, Director of Investor Relations. Mr. Williams, you may begin.

Robert Williams: Thank you.

With me today are Michael Dell; Brian Gladden, our CFO; and Brad Anderson who leads our Server Storage and Networking Solutions Group.

Brian and Brad will review our first quarter results then Michael will follow with his perspective on our growth strategy.

We just posted information on Q1 results and a vlog with Brian and Brad on our IR site at Dell.com. I encourage you to review these materials.

Our upcoming investor relations activities include the Bernstein CEO Conference on June 3rd and our analyst meeting here in Austin on June 23rd and 24th.

Next, I'd like to remind you that all statements made during this call that relate to future results and events including statements about Dell's future financial and operating performance, expected component pricing, global currency volatility, and anticipated customer demand 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 on our website. We assume no obligation to update our forward-looking statements.

Please note that on today's call we will be referring to non-GAAP financial measures including non-GAAP gross margin, operating expenses, operating income, net income, and earnings per share.

These measures are reconciled to the most directly comparable GAAP measures in the slide presentation posted on the Investor Relations portion of our website at Dell.com and our 8K filed today, which we encourage you to review.

Please note that unless otherwise mentioned all growth percentages refer to year-over-year progress.

Now, I'll turn it over to Brian.

Brian Gladden: Thanks, Rob.

We had a solid first quarter in an improving global environment. Demand has picked up especially with our commercial customers who make up approximately 78 percent of our revenue.

We had solid unit and revenue growth in the quarter. Solutions revenue which includes enterprise servers and networking storage and our services business was up 38 percent to $4.2 billion aided by the acquisition of Perot Systems. We also saw very strong demand in the emerging countries around the world.

Our entire commercial business continued to benefit from improved demand and the hard work we have done to improve our cost structure and the critical investments we're making to build out our enterprise business.

Our nearly $50 billion commercial business is performing well, and this validates our strategy to expand our investments in servers, storage, software, and services.

Given the strategic importance of our enterprise business, we've asked Brad Anderson to share his view on the progress we're making in enterprise solutions and discuss some of the underlying growth we're seeing there.

But first, let's look at the first quarter P&L and the key performance metrics, which are laid out on charts five and six in the web deck.

Revenue in the first quarter was $14.9 billion, up 21 percent year-over-year and flat sequentially. This is slightly better than our typical historical seasonality.

On a GAAP basis operating income was $619 million or 4.2 percent of revenue and earnings per share was $0.22, which is up 47percent year-over-year.

On the rest of this call I will refer to non-GAAP financial measures.

Operating income grew 29 percent to $824 million or 5.5 percent of revenue. Sequentially, gross margins improved slightly to 17.6 percent and our OpEx was 12 percent of revenue.

We continue to focus on improving operating income while making key investments in products and in sales and services resources.

Net income and earnings per share were both up 20 percent year-over-year. Net income was $584 million while earnings per share was $0.30 per share.

Our financing and other expenses were $68 million, up versus prior quarter driven primarily by currency valuation of certain balance sheet items due to a strengthening U.S. dollar.

Our tax rate was 22.8 percent and reflects the net benefit of certain effectively settled foreign tax audits. For the year, we do expect our tax rate to be in the 27 percent range consistent with our previous outlook.

We generated $238 million in cash flow from operations and $400 million in free cash flow in the quarter. Over the past four quarters we generated $4.3 billion in free cash flow.

As you know the first quarter is typically our weakest cash flow quarter as we make year-end bonus payments during the quarter. We also used about $130 million of cash to build some strategic inventory given the current component environment.

Our working capital performance continues to be solid. Our days receivable were flat with a one day increase in inventory days offset by a one day improvement in days payable keeping our cash conversion cycle at negative 36 days. We do expect our cash conversion cycle remain consistently in the negative mid-30s throughout the year.

We ended the quarter with $11.6 billion in cash and investments. During the quarter we reinitiated our stock buyback program with a buyback of $200 million. We've been saying we would like to restart the program as we've gotten more comfortable with the credit markets, our business performance, and other strategic cash usage requirements. We expect to continue a modest buyback program for the rest of the year.

As part of our ongoing efforts to optimize our capital structure and our U.S. liquidity, we're also monitoring the credit markets for possible favorable entry points.

Dell Financial Services generated almost $1 billion in new originations, up 11 percent. We saw strong leasing demand in large enterprise and in the U.S. in general.

The loss rate for our managed portfolio for the quarter was 7.6 percent which is down 130 basis points from last year as overall portfolio quality continues to improve.

At the beginning of the quarter we consolidated two commercial based conduits in accordance with recent changes in U.S. GAAP resulting in a net increase to financing receivables and debt of $609 million and $624 million respectively with minimal changes to retained earnings. This accounting change has no impact on our P&L or cash flow for the quarter.

Turning to our global business unit performance, our commercial business grew 22 percent to $11.6 billion with OpInc up 25 percent to $894 million.

We are beginning to see some leverage here and despite the fact we are making significant strategic investments in this part of the company. These results represent the best growth rates we've seen in commercial in the past two years.

Large enterprise grew 25 percent to $4.2 billion. OpInc in this business was up 47 percent to $283 million and improved to 6.7 percent of revenue. These results were driven by very strong server revenue growth of 61 percent in the quarter and good OpEx leverage, which we're been counting on as the growth returns. Client demand is also very strong with desktops and mobility growing 22 percent and 14 percent respectively.

Our public business grew 22 percent to $3.9 billion benefiting from the Perot Systems acquisition year-over-year impact.

Excluding the impact of the consolidation of Perot we saw muted demand in U.S. federal and our EMEA business. OpInc was up two percent to $298 million or 7.7 percent of revenue driven by stronger demand in state and local governments and emerging countries. Servers were up 17 percent in the quarter.

Based on 2009 revenue Gartner recently ranked Dell as the number one healthcare information technology services provider in the world, and we're beginning to see more synergy wins that we projected in this area.

Our small and medium business revenue was up 19 percent to $3.5 billion. OpInc grew 36 percent to $313 million or 8.9 percent of revenue. Our server storage and client businesses all delivered strong double digit growth in the quarter for small and medium business.

Our consumer business revenue was up 16 percent to $3.2 billion. OpInc was $17 million as we're are just beginning to see some of the cost benefits from consolidating this business with our SMB business. Our goal continues to be to improve operating margins to one to two percent by the end of the year.

Regionally, we saw solid revenue growth in the Americas and APJ which were up 23 and 33 percent respectively while Europe, EMEA, grew by six percent in the quarter.

Emerging countries continue to grow very quickly with our total revenue from BRIC countries up 60 percent and now representing nearly 12 percent of our total revenue in the company.

Moving briefly to a few key product highlights, on top of the strong enterprise growth that Brad will talk about, we saw strong return to growth in our commercial client business.

Revenue in mobility and desktops grew 18 percent and 13 percent respectively. Mobility units were up 27 percent while desktop units were up 12 percent.

Turning to enterprise, let me turn it over to Brad Anderson to discuss some of the success we're seeing in server storage and services.

Brad Anderson: Thank you Brian.

We had a strong enterprise solutions quarter. Our combined server, networking, storage services solutions grew 38 percent to $4.2 billion. A year ago we said we were going to shift our portfolio to higher margin and recurring revenue, and that's exactly what we're doing.

Let me give you some specifics.

In servers we are tying the market on Westmere and Nehalem EX, beating several key competitors to market. We launched a full range of Westmere blade, rack, and tower servers and the Nehalem EX blade and rack-based servers, as well as the only scalable two-socket server capable of supporting a half a terabyte of memory, which is really ideal for databases and virtualization.

Additionally, we shipped the industry's first portfolio of cloud-optimized servers, our PowerEdge C-Series, leveraging our unique learning's from our data center custom solutions business.

All of these provide significant returns on investment as customers consolidate, virtualize, and scale their data centers.

As a result, we are seeing a surge in server upgrades at higher ASPs. Server revenue was up 39 percent to $1.8 billion with units up 30 percent and ASPs up roughly seven percent.

In storage, we are focused on the full information life cycle for data access, data management, and data tiering.

We expanded our intelligent data management offerings by launching the Dell DX Object storage solution for healthcare and archiving, and we are expanding our partnership with EMC with the introduction of our Dell EMC deduplication and NX unified storage solutions.

As a whole, our storage revenue was up four percent to $554 million. EqualLogic and PowerVault led our revenue growth up 78 percent and 21 percent respectively. More importantly, our storage product mix delivered better contribution margins.

On acquisitions, the integration of Exanet and KACE are going well. Exanet provides us key file storage technology for our unified storage platform and KACE gives us a nice, eas-of-use system management platform for the mid-market.

And in networking, we launched our first set of Brocade products and this quarter we will add Juniper to our networking mix.

Finally, Dell Services grew 53 percent to $1.9 billion. The integration of Perot is progressing well. We are on target with all the key work streams including cost and revenue synergies.

As a combined organization, we're competitively strong and beginning to win business previously entrenched with the competition. We are effectively competing for a broader array of services contracts. We have identified now more than 300 synergy sales opportunities that are now progressing through the sales process.

In addition, both discretionary and outsourcing contract flows are gaining momentum as customers continue to focus on increasing efficiencies, reducing costs, and gaining access to more utility-based computing technologies.

As you can see, we're committed to unified business. We are seeing a very strong acceptance of our strategy of open, capable, and affordable solutions.

We look forward to discussing our approach with you in much more detail in June at the Analyst Meeting.

Now, let me turn it back to Brian.

Brian Gladden: Thanks Brad.

Before we hear from Michael, I'd like to provide some additional perspective on the quarter and our views on demand going forward.

As Brad described, we're experiencing very strong server growth on the heels of launching the Nehalem EX servers before our competitors.

As we indicated last quarter, we're also in the early stages of a large corporate client refresh, and we believe demand will continue to be relatively strong here.

We're primarily a commercial and increasingly an enterprise company.

While we suffered during the past 18 months of weak commercial demand, we stand to benefit in this cycle. Based on the first quarter reported IDC results, we're also fared better in the share metrics than we have in awhile.

As we said, we saw resurgence in commercial desktop and mobility demand in the first quarter and that should continue for the next several quarters.

We look forward to the growth here as it drives scale, operating leverage, and pulls through higher margin services and S&P business, even though it may pressure gross margin for us.

For the second quarter, we expect seasonal improvements from our state and local government, consumer, and education businesses.

But it's also important to note that the second quarter and the first part of the third quarter are generally periods where we see slower demand from larger commercial customers in the U.S. and especially Europe.

Net for Dell, we expect a normal seasonal pick-up in the low single digits into next quarter.

We expect some components to remain in tight supply with limited deflation for the next couple of quarters and global currencies to remain somewhat volatile, especially the Euro.

We continue to manage OpEx in a disciplined way with lower spending in G&A and our client business offset by key investments in our solutions business focused on products, IT sales and services.

We'll be disciplined here, but we are committed to making these investments while the environment allows it.

Finally, we are committed to growing operating income dollars while maintaining disciplined execution on working capital and our cost structure.

With that, let me turn it over to Michael.

Michael Dell: Thanks Brian.

We're really excited about the growth in our commercial businesses right now and had strong showings across all of our enterprise solutions businesses – servers, networking, storage, and services.

Our solutions revenue is on a $17 billion run rate, delivers gross margins in the low-30s and now contributes more than 50 percent of the company's gross margin dollars.

In our commercial business, solutions revenue grew 41 percent from a year ago and represents 35 percent of revenue. This is a five-point mix shift from a year ago and an eight-point shift from two years ago.

These solutions are resonating with customers and were winning. Enterprise is a big part of our growth strategy and we plan to fully participate here.

While this growth is important to our long-term success, we're also at the front end of a powerful refresh in the corporate and public client business.

We estimate that less than five percent of large commercial customers worldwide have made the transition to Windows 7 and Office 2010.

We are also seeing server and storage refresh rates accelerate as customers virtualize their data centers and transition to the latest technology.

Both of these trends will be powerful catalysts for Dell's growth to help fund current and future investments.

With that, let me now open to the operator for questions.

Robert Williams: Thanks Michael.

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

Operator, can we have the first question?

Operator: Ladies and gentlemen, we'll begin the question-and-answer session portion for today's call.

If you have a question, please press star-1 on your telephone keypad. You will be announced prior to asking your question. If you would like to withdraw your question, press the pound key.

One moment please for the first question.

Our first question comes from Katy Huberty with Morgan Stanley.

Kathryn Huberty: Good afternoon. Nice revenues in the quarter. Brian, question for you.

At the Analyst Day last July, you talked about seven percent plus operating margins in a period of strong growth, driven by the higher-margin corporate revenues, and this is the first quarter that we've seen that significant mix shift away from consumer towards SMB and enterprise.

So I wonder if you can just comment on whether the operating leverage and the model was as you expected, and if that seven percent operating margin target is still a good stretch goal to think about for the back half of this year and 2011? Thanks.

Brian Gladden: Katy, that's still our target, and we talk about that as more of a longer-term target that we're driving towards.

I think as we've talked about it, there is nice leverage in our business when we see the commercial business demand come back, and we're seeing that. If you look at the results in the commercial businesses and LE and SMB and even public, ultimately, nice leverage with the demand coming back.

But we've also said that we're going to make some pretty significant investments in shifting the business and building out our enterprise business. And I think that's a balance that we're trying to work through as we move forward. But the leverage is clearly there, and we are still targeting the seven percent.

Kathryn Huberty: And given the strong revenue performance you had in enterprise and SMB, should we expect the investments for growth in those areas to accelerate in the near-term?

Brian Gladden: I think we are being disciplined. And if you look at how we're managing OpEx, you'll see the leverage that we're getting with the volume growth and the unit growth.

But we are simultaneously executing on cost reductions in the business in places like G&A while we're investing in some of these key enterprise areas, whether that is product R&D or whether that's sales and service capabilities.

Kathryn Huberty: Got it. Thank you.

Operator: Our next question comes from Brian Alexander with Raymond James.

Brian Alexander: Thanks.

It seems like the strong leverage in the SMB and enterprise sectors was offset by public sector, and I realize Perot got a dampening effect on the margins in that business, but it looks like they would've been down considerably, even excluding Perot.

So, could you talk about that? Is that being driven by the mix shift toward emerging markets? And could you just talk about your outlook for profitability in the public sector for the balance of the year? Thanks.

Brian Gladden: Yes. I mean, Perot really doesn't have a big mix down impact on the business. It's, as you saw the results of that, the business before we acquired it. It's a seven percent or seven percent plus operating income business.

The pressure we see in public was really the softness in U.S. federal business and EMEA. And I would call out specifically the U.K. government business was pretty weak. Those are businesses that are typically pretty high enterprise mix, and therefore, pretty high margin.

So that's the short-term dynamic we're managing through in the public business. But, we still like the profitability there and still like the growth prospects and, were' well positioned to go forward.

Brian Alexander: So you think this is just a temporary lull, Brian, and we can get back to high single, potentially 10 percent-type operating margins over the next 12 months?

Brian Gladden: Yes. I think we have to watch the growth dynamics in that sector. Obviously, there are places where we see government deficits that are going to affect spending but, we still think it's a great business and we'll continue to invest there.

I think there is margin upside going forward in that business.

Brian Alexander: OK. Thanks a lot.

Operator: Our next question comes from Richard Gardner with Citigroup.

Richard Gardner: I was wondering if you could talk about gross margins?

I know you manage the business to the operating margin line. But, I think the Street had perhaps expected a little bit more of a gross margin rebound, given the more favorable customer mix you had in the quarter.

I suspect you're going to talk about things like component pricing and, I don't know, maybe even a mix shift to the channel.

Can you talk about whether those are the right things to think about or was there also competitive pressure in the quarter?

And is mid-17s sort of the new level to be thinking about or do you still think that gross margins can get back to the 18 level or better in coming quarters? Thanks.

Brian Gladden: Yes, Richard, I think you got it. We're focused on driving operating income dollar growth and, you know, we feel good about the progress we made in the quarter.

We did improve margin rates by about 20 basis points versus where we were in the fourth quarter. We said we were going to move it forward.

We did see the favorable mix impact of the consumer business being seasonally down but this was, if you look at the dynamics on the commercial side of the business, it was offset by strong growth in the client business within commercial, which obviously within commercials at lower rate.

So those dynamics more or less offset each other.

We also saw negative mix from the very strong growth in APJ and some of the emerging countries. So, India and China obviously contributing to that.

So those are some fundamental dynamics we're facing. And, the reality is we're focused on continuing to drive operating margin back up and, you'll see that progress.

Richard Gardner: Can you specifically discuss any impact from competitive pressures or any pressures that you saw during the quarter, Brian?

Brian Gladden: Yes. I wouldn't call anything out. I think there's a lot of good demand out there. The markets are feeling better and there's good competitive dynamics out there. That's nothing unusual.

Richard Gardner: OK, thank you.

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

Toni Sacconaghi: Yes, thank you.

I wanted to follow up on the previous question, specifically on what you saw in components in the quarter.

One factor that you highlighted last quarter was you'd gotten caught in a series of retail commitments, and then faced a big spike – unexpected spike in DRAM pricing in the middle of the quarter, which hurt you. Ostensibly, that didn't repeat itself, and so, again, I'm kind of surprised that there wasn't more gross margin leverage as well.

Can you talk about what happened in terms of components in the quarter and how that may or may not have impacted margins? And then, given the strategic inventory purchases, which I gather are component pre-buys, can you talk about how you think components may or may not impact you in Q2?

Brian Gladden: Toni, I would say we talked about the challenge with the timing of retail matching our buys with pricing and we've more or less fixed that process in the business. So, to your point, that's not something we're at all calling out in the quarter and it's something that I think we've managed pretty well.

I would say that components continue to be relatively tight. Memory has been a bit of a challenge. I think from our perspective and I think from the market's perspective what you'll hear is that that will continue to be a challenge for the next couple of quarters.

What we've done is lock in supply to the point where we're generally feeling pretty good about our capability to meet our needs on the supply side.

I would say that the reality is there is going to be continued pricing pressure there and components are not going to be seeing the typical deflation that we've seen. So we'll continue to manage through that. I think we've done a better job this quarter in terms of passing that through and pricing in the marketplace, and that's something we just got to continue to do.

Toni Sacconaghi: On the demand side, can you comment on linearity in the quarter, particularly in light of heightened concerns around macro, particularly Europe? So, was demand linear? Did it actually improve over the course of the quarter? And so, if you look at this quarter, how was linearity? And, if you can comment on the first 20 days of this month, that would be appreciated as well.

Brian Gladden: Yes. Toni, I would say pretty linear. There were puts and takes around the world but on a global basis pretty linear demand, and as we looked at second quarter, we talked about in our outlook that we would see the typical sort of seasonality we usually see given our exposure to the education and state government and that would say we're going to be up two to three points versus first quarter and the second quarter, and everything we've seen in the quarter so far supports that.

Toni Sacconaghi: Thank you.

Operator: Our next question comes from Bill Shope with Credit Suisse.

Bill Shope: Thanks guys.

Given your investment goals and balanced against your efficiency efforts, how should we think about the OpEx ratio this year? How should it trend from the levels we saw this quarter? Should we expect to see leverage here or is the focus really this year on longer term growth investments?

Brian Gladden: You'll see that we'll try and manage it in a bit of a balanced way. We're going to make the investments. There is no question. I wouldn't expect an awful lot of leverage given that dynamic, and in this market, we're going to make those critical longer-term investments for the business.

Bill Shope: So with that said, as a follow-up, you do expect leverage this year, but you don't expect it from the OpEx ratios, so implicitly you expect it to come from the gross margin line?

Brian Gladden: I think you will see some leverage in OpEx but, as I said earlier, we're going to continue to work to improve gross margins as well. It's all about operating income dollars.

Bill Shope: OK, great. Thanks a lot.

Operator: Our next question comes from Jayson Noland with Robert Baird.

Jayson Noland: Thank you.

EqualLogic was strong again in the quarter. Are there any financials you can offer up?

Brian Gladden: Revenue in EqualLogic was up I think 78 percent year-over-year. It continues to be really, a great product line – lots of growth there. You know, Brad's here. Maybe he can talk a little bit about it.

Brad Anderson: Yes. We had a record quarter. We continue to, see good growth in all sectors. It was particularly strong in public and SMB worldwide. And we're seeing increasing where we have sold one array, we're seeing now the repurchases of expanding that from one to two to mobile set of arrays, so now, we have an installed base.

When we think about where we're at when we first bought them, we are now with about 18,000 arrays out in the field. So we've really grown that installed base.

Jayson Noland: And just as a follow-up, what type of overall storage attach rate are you seeing to your server sales?

Brad Anderson: We're not tracking it as server attached but we're seeing two things here. We're seeing a large number of sales into our installed base but we're also seeing very attractive getting us into new accounts where we previously weren't in. So it's expanding our reach into a set of customers that we weren't previously selling to as well.

Jayson Noland: Thanks, Brad.

Operator: Our next question comes from Steven Fox with CLSA.

Steven Fox: The growth in the BRIC countries over the last couple of quarters has really picked up. Are there any one or two strategies that you would particularly point to that are driving it? I know you've talked about a bunch over the last year, but I'd love to get some more details on it.

Brian Gladden: Sure. We're seeing growth really across all four of the businesses in all of the BRIC countries. BRIC plus ten was up 57 percent. The ten being kind of the next generation of significant emerging countries.

So, the large enterprise business was very strong. Public was pretty strong. This would have been not the strongest quarter for the public business in BRIC. SMB was quite strong. Consumer continues to be strong. Really great growth in India and Brazil. India is up 90 percent and Brazil is up 81 percent, and Russia is 79.

We see a lot of growth here. And, our strategies are really, really working across all of the businesses and there's a lot of strength in the brand in these countries.

So if you go to China, India, or Brazil on the ground, Dell has a significant presence and is really moving quickly.

Steven Fox: Thank you for that. And then, Brian, is there any specific currency assumptions that you can comment on that are baked into the numbers that we can benchmark as we go forward?

Brian Gladden: We generally don't talk about currency a lot. As a global company, we manage it.

I would say we've been pretty open about the fact we generally have a longer window of hedging than most of the competitors, and therefore, we try to manage out the volatility over a period of a few quarters.

I think we've done a nice job managing it, and obviously over time, we have to make sure our teams can react and price appropriately given what's going on with currency over time. But we really don't like to talk about it as a major driver of the business.

Steven Fox: OK. Thank you very much.

Operator: Our next question comes from Ben Reitzes with Barclays Capital.

Benjamin Reitzes: Yes, thanks a lot.

Michael, your largest competitor just announced they're buying Palm, and obviously, we're seeing pretty explosive success of the iPad. I was wondering if you could comment on what, just a little bit more on Dell tablet and cell phone or smart phone strategy and whether any moves or recent, you know, movements with the iPad or moves by HP changed your view at all and maybe a little bit of outlook on whether you need to make an acquisition in that space? Thanks.

Michael Dell: Well, I think one of the most immediate opportunities we see with all of the users coming online is the tremendous build out of the data centers to feed all that data.

So we're very focused on our data center custom solutions business in providing the infrastructure to all of the content providers and telcos that are feeding up all that data. A lot of data would suggest we're supplying about 19 of the 25 largest websites in the world and really continue to have a significant presence in that tier.

You're also starting to see us a bit in the device side. We're very much working with Android and Windows Mobile 7. We see those platforms as more attractive alternatives to other suggestions you may have offered.

Benjamin Reitzes: Got it. And, with your experience in the industry, what do you think of the tablet space in general? Do you think it's disruptive, additive, doesn't cannibalize? And do you think that it has any impact on your corporate business, actually, eventually, and not just consumer?

Michael Dell: Well, I think it's pretty interesting. Whenever a new device comes along, it's always kind of fun to get one and play around and kind of see what it is all about.

My view is that these devices are really good for content consumption and they're not so much content creation devices. And they also appear to be devices that create a whole new usage pattern and a whole new demand for data which is a good thing. And they don't necessarily replace any existing device per se.

Could you on occasion use this device instead of another device? Yes. But generally speaking, the tablet form factor looks to me like a whole other device and a whole other purchase pattern.

Benjamin Reitzes: Thanks a lot. I appreciate it.

Operator: Our next question comes from of Maynard Um with UBS.

Maynard Um: Hi. Thanks.

First, can you just help us with the pro forma gross margins between your product and services segments? Of the $98 million, how do you break those out between the two segments? Because making some assumptions based on your previous acquisitions, it looks like you might actually be seeing some lower or pressure on your services gross margin. Could you just tell me how that splits out and if that's correct? And then, I have a follow-up.

Brian Gladden: Yes, if you look at the reported data around our services business, as we look at Perot, Perot would ultimately mix down the margin rates for our services business. But at the OpInc line, it's basically about the same operating income or slightly better than the company.

So, as a service asset, clearly an important asset for us, but you will see some dilution in the services gross margin over time because of that.

Maynard Um: OK. And then secondly, just curious about the use of cash, does your share repurchase signal a changing kind of M&A strategy and can you give us maybe any thoughts into a timing of some of the potential things that you had been talking about in the past? Thanks.

Brian Gladden: Yes. I think we've been obviously fairly transparent on our strategic needs and I think that continues to remain a priority.

The signal you take from the buyback would really be around our comfort that the business continues to perform well, that the credit issues that we were troubled with a year and a half ago are really behind us.

And then we've gotten comfortable with what it is we need to accomplish in that plan, you know, in terms of strategic other uses.

So, that's how I would read it. Again, I would say we expect to have a relatively modest repurchase plan for the rest of the year.

As we said before, I think we said it last quarter, we would expect to be somewhat balanced and like to do both of those things – make strategic investments but also do buyback.

Maynard Um: OK. Thank you.

Operator: Our next question comes from Chris Whitmore with Deutsche Bank.

Chris Whitmore: Hi. Thanks very much.

You reiterated your consumer margin targets for the year. What are the top one or two levers that you'll pull to get there?

Brian Gladden: Well, I think the biggest thing we've talked about is continuing to work costs in the consumer business.

And, you know, as we announced in the last quarter, we've consolidated the consumer business with the SMB business and that creates for us some nice leverages on the cost structure to those businesses we've just begun to sort of realize some of those benefits.

And I would also say that, as we continue to work aggressively to reduce the COGS and the cost of our consumer products. Those are the two biggest levers we have as we continue to grow there.

Chris Whitmore: Can you quantify the expense reductions that are under your control that you've identified for reduction?

Brian Gladden: Yes. Well, we talked about it last quarter. There's a couple hundred million dollar opportunity we're going after in terms of the consolidation of those two businesses.

Chris Whitmore: Thank you.

Operator: Our next question is from Mark Moskowitz with J.P. Morgan.

Mark Moskowitz: Good afternoon.

Brad or Brian, I want to understand more of the gross margin dynamics in the commercial business, just given the comments earlier about the Nehalem and Westmere boxes being sold with higher ASPs because of the denser configurations.

In the quarter reported, should we think about that, then, as maybe offsetting lower margin contribution from the client business, that ramps, and what happens longer term if the client starts to really see a refresh cycle pick up? Will that overcome or offset these better margins in the server business?

Brian Gladden: Mark, I do think that is one of the short-term dynamics that we're facing into, that there will be strong growth on the client side of our commercial business.

And we think that is a great thing. That for us creates obviously scale. It obviously creates opportunities to attach and sell other products that are very high margin. And that's just a dynamic we're going to face into.

And then reality is it's going to drive more operating income dollars for the company. It may create in the commercial business some pressure on gross margins. I think that is OK. That's been the long-term direction we're driving and continuing to grow our enterprise business in 38 percent. That's the big measure of success in terms of our transformation, and I think it is important that we make progress there, too.

Mark Moskowitz: And then as a follow-up, Michael or Brian, just given the momentum you are seeing in BRIC and APJ, in particular, should we think about Dell maybe getting more acquisitive from a services perspective next to layer into that momentum?

Michael Dell: We wouldn't want to signal acquisitions before they occurred – generally not a good strategy. But, certainly, as Brian said, we'll continue to be acquisitive and there are certainly capabilities that we'll want to add to our portfolio.

Mark Moskowitz: Thank you.

Operator: Our next question comes from Aaron Rakers with Stifel Nicolaus.

Aaron Rakers: Yes. A follow-up question on that last one.

When I look at your consumer gross margin or implied gross margin trends given your filing disclosures over the last couple of quarters, it looks like it's come under quite a bit of pressure.

Could you talk about our consumer segment gross margin trends here in the context of getting back to your seven percent kind of targeted overall corporate operating margin level?

Brian Gladden: Yes. I don't think we publish or share any of the consumer gross margin details.

You would see operating income on the consumer business and, again, I think that's been relatively consistent in the something under one percent for the last year with the exception of the second quarter last year.

I think the context and the framework we've created for the seven percent operating income would count on the consumer business in the two percent plus sort of range and I think we can get there with that.

So, again, the consumer business is important for us from a scale standpoint, but, we think it can generate two percent plus kind of operating income.

Aaron Rakers: OK. And then a follow-up then would be is on when you talk about the Nehalem EX and Westmere platforms, it looks like your server business was down slightly on a sequential basis.

Your closest peer reported something out of a – I think it was a four percent sequential growth. I guess the question would be did you see any type of pause or, you know, kind of deferral in terms of spending with regard to the Nehalem EX platforms and the Westmere platforms coming out in this last quarter?

Brad Anderson: No, we didn't.

Typical seasonality is down quarter-over-quarter, and in fact, we were essentially flat. I think maybe it rounds to minus one here. But no, we didn't see a pause throughout that period for both Westmere and Nehalem Ex.

And the Nehalem EX, since it goes into the four sockets, you're seeing now the start of the qualification and validation for that.

So I think you are going to see continued pick up on the Nehalem EX as now people get past their own internal qualification processes and move more into production buying pattern.

Aaron Rakers: Thank you.

Operator: Our next question comes from David Bailey with Goldman Sachs.

David Bailey: Great, thank you.

Inventory was up 12 percent or so quarter over quarter on flat sequential revenue, and I know you said you've made some strategic purchases in the quarter. Should we expect this trend to continue as we go forward or should inventories start to track revenue more closely?

Brian Gladden: Yes, David, we feel pretty good with the level of strategic inventory we have right now. I wouldn't expect a dramatic change in that. Reserve the right given the component kind of environment to maybe do something there.

The other dynamic that's going on obviously as we see the growth of the retail business and as we see the ability to put more product on the water, those are things that are obviously putting pressure on inventory. I think we have managed that pretty well in the quarter. That was a minimal impact. But again, I think you can expect it to be pretty flat. We're trying to manage it around the eight or nine days right now.

David Bailey: Great.

And then on the services side, you said that you saw discretionary and outsourcing contract flows start to pick up a little bit. I was wondering if you could give a little more detail on that, either by industry vertical or geography.

And as you see more new contracts signed, does that put some gross margin pressure on as those contracts start up?

Brian Gladden: To the second part, yes. As you start up and see some growth come back to that part of the business the initial economics aren't terrific necessarily as you start up these contracts.

And we are seeing a good pipeline and some nice return to growth there. I think healthcare is one area that I call out that we would say has been especially strong from a vertical market standpoint.

Michael Dell: Yes. There is a significant amount of activity among community hospitals, for example, in the United States that are implementing hospital information systems, and we have lead share in that sector and we think there is going to be a very robust environment for that kind of IT activity.

David Bailey: Great. Thank you.

Operator: Our next question comes from Shannon Cross with Cross Research.

Shannon Cross: Thank you very much. Good afternoon.

Brian, if you could talk a little bit about cash flow from the standpoint of, you know, what you saw, puts and takes. Clearly inventory was used this quarter, but then more importantly sort of as we go through the year, can you give us an idea of how we should think about operating cash flow sort of quarterly and things just to keep in mind, you know, from a seasonality standpoint?

Brian Gladden: Yes. The first quarter as we said is generally our weakest cash flow quarter. Obviously one of the things we do is our bonus payout. That was a driver in the quarter.

Working capital we've said we expect to continue to keep that in the mid-30s, negative mid30s, so not a dramatic move one way or another. And you may see a couple of days here and there but that's generally pretty solid.

We've generated $4.3 billion of free cash flow for the last four quarters on a rolling basis. And, it's something similar we would expect this year. There may be some seasonality as it relates to linearity in our revenue growth that affects working capital but I think about it on a rolling 12-months kind of basis and that is the best way to think about it.

Shannon Cross: OK. Great.

And then, Michael, can you talk a bit about – again, having been through some of these refreshes before, with Win 7, I think, I don't know, I've seen five percent to eight percent of PCs have been sort of refreshed at this point in time.

Can you talk about how – I know you've talked about it before, but how you see this rolling out? More importantly, how we should think about ASPs, and, you know, given what's going on in the component side and what's required for Win 7, just anything you can give us, because, again, there's a lot of used equipment out there clearly that people can kind of, you know, pull in and replace in some kind of a different time. So anything you can give us there, that would be helpful. Thanks.

Michael Dell: I think it is a fairly unique time because the age of the installed base is as great as it has ever been and there wasn't really a catalyst or series of catalysts to upgrade and now we believe there is. And we are seeing significant projects and conviction among customers.

What I'd also tell you is that there is a real shift towards more of a data center based client model in the various forms whether it's client virtualization. So there is a shift in where that spend is going to more server storage, with our PowerEdge EqualLogic platforms.

So far the dynamic that Brian described I think you're going to see that play out here a bit where we have increased operating income from growth in the client business, but that obviously pressures gross margin somewhat.

So, operating income growth is what we're focused on here. I do think you will see the server and storage businesses continue to grow faster.

Shannon Cross: Great. Thank you.

Michael Dell: Services as well.

Shannon Cross: Thank you.

Operator: Our next question comes from Rob Cihra with Caris & Company.

Robert Cihra: Hi. Thanks very much.

This is maybe for following on the last point. But you did talk about corporate recovery just beginning and getting better through the second half. And in fact, yes, you already had this, I guess, the third quarter of sequential improvement in corporate.

I'm just curious, I guess, if we're rebounding from an awfully weak several quarters, why the Q2 outlook calling for seasonally slower large corporate demand? I mean is there – if we were really rebounding and refreshing, wouldn't we be able to have sort of a better than seasonal corporate outlook in the second quarter? Thanks.

Brian Gladden: Yes, we're building off of a pretty nice rebound we saw even into the fourth quarter. We talked about a bit of a budget flush and we saw basically almost counter seasonal growth or flat revenue into the first quarter.

I think it's been a little bit better than we've expected and better than we anticipated and talked about. But, I do think you will see the typical slow down in terms of large corporate transactions during the course of the summer, especially in Europe. That's just a dynamic that you face. So, that's the reality of the market.

Robert Cihra: OK, great. Thank you.

Operator: Our next question comes from Jeff Fidacaro with Susquehanna Financial Group.

Jeffrey Fidacaro: Great. Good afternoon.

Just wondering if you can give us a little bit of color on the general outlook on the growth trajectory for notebooks and any color specifically within Europe. You know, some of the competitors have been talking about having to possibly raise prices in that region. And if I take a look at just this quarter, the implied ASP was down a bit on your notebook space.

Brian Gladden: Yes, obviously the growth is coming back on the commercial side. Average selling prices for us have been more stable, obviously, than they were last year on the notebook side, as well as desktops.

When you talk about Europe, clearly, as you look at currency sort of moving through the system over a period of time depending upon sort of hedge windows and timeframes, for anybody, for any of the competitors to protect margins there, they're going to have U.S. dollar exposure and selling into a Euro market they're going to have to raise prices ultimately.

So, that's just the reality we're going to see and over the next couple of months if you see the U.S. dollar and Euro continuing the current relationship, I think that's just the reality. And it probably will ultimately affect demand.

Jeffrey Fidacaro: Great. Thank you.

Robert Williams: Let's take one more question, operator.

Operator: Understood.

Our final question comes from Louis Miscioscia with Collins Stewart.

Louis Miscioscia: Wow. Maybe I'm under the deadline here. Sure, my question is actually on cloud computing.

When I do some checks, I do hear that a lot of folks are choosing Dell servers for that. Can you mention are you actually using racks or blades, selling more for that? Is this starting to be a meaningful portion of your business and are you specifically customizing off the normal standard sheet that you have for different customers with that? And then, one follow-up.

Brad Anderson: Yes. We formed a custom data center solution group about two and half years ago. And I think Michael alluded earlier, where most globally the largest data centers moving this kind of hyper scale cloud computing model is deploying on those platforms. And then we're winning more than our fair share of that volume and are now leading in providing those class of solutions. And that business continues to be very strong. It was particularly strong this quarter and it's improved quarter-over-quarter for the last several quarters.

What we've done this quarter in addition to that is that there's a lot of unique learnings from that offering, and we have now taken those learnings and created a more standard line of a product called the PowerEdge Series C to take those, to be able to transfer those learnings into a tailored offering for more of the Fortune 500 type of accounts that are looking at putting in their own private clouds.

So we think that is going to be really a strong lineup and we just launched that in mid-March. So we think that's some upside going forward.

Louis Miscioscia: My follow-up was on desktops.

Just a little surprised to, obviously, see desktops growing faster quarter-to-quarter than notebooks. Just maybe you can give us some thoughts as to what dynamics are going on underneath that?

Michael Dell: Well, I think that's the refresh cycle and obviously Q4 is a seasonal period where there are a lot of consumer notebook purchases.

Louis Miscioscia: OK. Thank you.

Robert Williams: OK, great. Thanks everyone. We'll talk to you soon and look forward to seeing you here in Austin next month.

Operator: Ladies and gentlemen this concludes today's conference call. We appreciate your participation. You may now disconnect.

END