DELL, INC.
FISCAL YEAR 2012 SECOND QUARTER
EARNINGS CONFERENCE CALL
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OPERATOR: Good afternoon and welcome to the Dell Inc. Second Quarter Fiscal Year 2012 Earnings Conference Call. I'd like to inform all participants this call is being recorded at the request of Dell.

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 any time during the presentation. I'd like to turn the call over to Rob Williams, Vice President of Investor Relations.

Mr. Williams, you may begin.

ROB WILLIAMS: Thank you.

With me today are Michael Dell, Brian Gladden and Brad Anderson, Senior Vice President of our Enterprise Solutions Business.

Brian and Brad will review our second quarter results, and then Michael will follow with his comments. We have posted a web deck on dell.com and we released a V-log with Brad and Brian on Dell Shares. I encourage you to review these materials for additional perspective.

In Q3, we will attend the Citi Technology Conference on September 7th, and the UBS Best of America Conference in London on September 9th.

Next, I would 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 disclosed in our annual and quarterly SEC filings and in the cautionary statement contained in our press release and in our web deck. We assume no obligation to update our forward-looking statements.

Please also 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. Historical non-GAAP financial 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 in our press release included in our 8-K filed today. I encourage you to review these documents.

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

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

BRIAN GLADDEN: Thanks, Rob.

The second quarter is another proof point that we're executing well against our strategy. We've put a big focus on accelerating revenue growth in our Enterprise Solutions and Services Business, and we've refined our strategy to focus on three solutions domains. The first domain is Next Generation Computing Solutions and Intelligent Data Management. The second domain is Services, Security and Cloud. And the third domain is End User Computing.

A key point of differentiation in our strategy is our mid-market design focus, which provides open systems that are highly capable, affordable, and flexible enough to scale and meet the needs of large enterprises, public institutions, and mid-sized businesses. We're making significant and thoughtful investments to develop and acquire industry leading intellectual property in systems management, storage, security and networking.

Good proof points thus far are the accelerated growth in KACE Systems management, the broader adoption of EqualLogic and Compellent Storage Solutions, and SecureWorks Managed Security success. And now we're very excited about adding Force 10 Networks to our business. We're also significantly increasing investment levels in our sales and go to market capabilities across the business. These investments are substantial, and are now contributing to our growth, shifting our mix, and improving our operating income.

At its core, our strategy builds on Dell's unique ability to deliver a set of competitively differentiated mid-market solutions.

Our first half results clearly demonstrate our ability to execute our strategy and win in the marketplace. We delivered very good financial results with first half revenue up 1 percent, and non-GAAP operating income up 59 percent year-over-year. As part of our strategy, we continue to make deliberate decisions to eliminate low value-added revenue from the portfolio, and focus on key strategic areas for growth.

There is no question that our revenue growth is being impacted by our strategy, but that's a tradeoff we're willing to make. Our core business remains healthy, and we continue to see solid demand for our server, Dell Storage and Services businesses. As we continue to execute on our cost initiatives across the business, and focus on higher value products with Dell-owned intellectual property throughout our business, our product margins remain strong, and contributed to outstanding operating income and excellent cash flow generation this quarter.

Let's review our second quarter results. The key performance metrics are provided for your reference on pages 5 and 6 in the Web deck. Consistent with our outlook provided in May, revenue in the second quarter was 15.7 billion, up 1 percent year over year, and up 4 percent sequentially. Our Enterprise Solutions and Services business grew 4 percent to $4.6 billion. On a GAAP basis, operating income was $1.1 billion, or 7.3 percent of revenue. We delivered earnings per share of 48 cents, and earnings per share was up 71 percent year over year. For the rest of this call, I'll refer to non-GAAP financial measures.

We delivered 23.2 percent gross margins driven by continued strong product/cost execution, disciplined pricing, and ongoing shift to higher value Dell technologies. We continue to eliminate lower margin business that's not strategic to the company long-term. Specific examples of this including exiting lower value reseller business in both storage and software, as well as unfavorable retail and reverse auction deals in our client business.

OPEX was $2.3 billion or 14.7 percent of revenue. The sequential increase in OPEX was driven by a shift in mix of the products in our business. We are selling more Dell technologies that bring higher margins, but also require higher levels of R&D and higher selling costs. These spending increases are deliberate and well aligned with our transformation.

We've been pretty transparent of our intent to make these investments in the enterprise, and we'll continue to do so while at the same time tightly managing G&A, the discretionary costs elsewhere in the business. Additionally, OPEX is also higher due to incentive-based compensation associated with the strong profit performance we've experienced through the first half of the year.

Operating income grew 52 percent to $1.3 billion, or 8.5 percent of revenue. The commercial segments as a whole delivered 10.5 percent operating income, representing a 280 basis point increase from the previous year. Interest and other expenses were $55 million driven by approximately $70 million in quarterly interest offset by investment income.

For the quarter, our tax rate was 21 percent, consistent with our outlook, and consistent with prior quarters. Earnings per share increased 69 percent year over year to 54 cents per share. In the quarter, vendor settlements resulted in approximately a $70 million benefit that increased gross margins 50 basis points, and earnings per share by 4 cents.

In the second quarter, our cash conversion cycle was a negative 34 days, days payable improved five days driven by linearity, and increased contract manufacturing volumes offset by a typical seasonal increase of two days in day sales outstanding while day's inventory remained flat. There is no change in our view that our cash conversion cycle will remain in the mid negative 30s over the course of the year.

Finally, a real highlight for the quarter is the record $2.4 billion we generated in cash flow from operations, and we've now delivered $5.2 billion for the trailing four quarters. And we ended the quarter with $16.2 billion in cash and investments as well as repurchasing $1.1 billion worth of stock as we called out at the Analyst Meeting in June.

Now, let's take a look at the lines of business, and regional performance which you'll find detailed on pages 11 through 15 of the Web deck. Enterprise Solutions and Services revenue grew 4 percent to $4.6 billion driven by strong performance in servers, Dell Storage and services. Brad will discuss server and storage businesses in just a moment.

Dell Services revenue grew 6 percent to $2 billion. We saw very good growth from new signings in the quarter. That will lead to future top and bottom line results.

The total contract value of new contracts signed in the last quarter was $1 billion and was $1.3 billion for the first half. As you know, new signings in this business tend to put initial pressure on the P&L, but later generate sustained profit over the life of the contract. In addition, we continue to see increased demand for our SecureWorks managed security offerings and added 200 new customers this quarter.

Our services backlog is now $15.4 billion, up 11 percent from a year ago. And this is split between $6.8 billion in deferred extended warranty and $8.6 billion in contracted services backlog.

Our client business continues to be strong. We have significantly improved gross margins and operating margins, even while managing through a significantly lower cost deflation environment in the quarter. We've now sustained client OpInc above 5 percent for the last three quarters, and believe we can maintain this level of profitability on a sustainable basis. In our second quarter client revenue was up sequentially 6 percent, and down 1 percent year-over-year to $8.5 billion, driven by our public business, where client revenue increased 34 percent sequentially.

We're seeing similar profitability improvement in our software and peripherals business, where gross margins have improved over 400 basis points year-over-year, and 80 basis points sequentially. S&P grew 1 percent to 2.6 billion, as we focus on significant pruning activities. And it now represents 16 percent of our revenue. This is a good example of an area where we're exiting portions of the business where margin rates and returns are low, and products are not strategic to our solutions focus.

For example, we've reduced and eliminated a large number of consumer electronics offerings. Also, reselling of third-party software is an area where we would selectively eliminate low value and low margin offerings. Growth markets continue to be strong. We defined growth markets as markets outside the U.S. and Canada, Western Europe, and Japan. These geographies now account for 28 percent of Dell's revenue and revenue was up 14 percent over the previous year.

Specifically, India and China were up 21 and 20 percent respectively. Regionally, revenue in APJ and EMEA grew 17 and 1 percent respectively, while revenue in the Americas was down 4 percent. In APJ enterprise solutions did well, with profitability up nicely there.

Turning to our segment level performance, which is detailed on pages 16 through 20 in the Web deck, large enterprise revenue was up 1 percent to $4.6 billion, led by strong demand for servers and services. Server growth was 5 percent, and services growth was 11 percent. OpInc as a percent of revenue improved 350 basis points to 9.8 percent of revenue, and generated $448 million of operating income.

Our public business achieved record profitability in the quarter. Overall public OpInc was $484 million and improved 290 basis points to 10.9 percent of revenue. Public revenue was down 3 percent year-over-year, but up 18 percent sequentially to 4.5 billion. Consistent with our outlook, public saw a typical seasonal up-tick in revenue, that was most notably in our client business, which increased 34 percent sequentially.

We experienced strong second-quarter sequential demand for servers, storage, and services, but see continued weakness in Europe, in the U.S. federal business. We're keeping a close eye on the U.S. federal spend, through its fiscal year end ramp on September 30th. The pipeline of opportunities focused on government productivity is actually very good, but will still depend on how quickly these opportunities close over the course of the quarter.

Small and medium business revenue grew 5 percent to 3.7 billion. In the second quarter servers, storage, and services grew year over year. And most of the remaining EMC storage business has now transitioned to Dell technologies. Overall in the second quarter we delivered operating income of $404 million, or 10.9 percent of revenue, which is a 180 basis point improvement year-over-year.

Consumer revenue was up 1 percent, to $2.9 billion, driven by strong growth in EMEA and APJ, whereas Americas revenue declined. We're actively managing this business and moving our product portfolio to higher value products, while exiting lower margin products in the retail business.

We're gaining share among mid-range and high-value products, consistent with our strategy.

We saw some softness during the last month of Q2, and moving into the third quarter, and specifically U.S. consumer has been weaker than we expected. We will continue to monitor demand dynamics closely in light of the current macro-environment. Overall, consumer delivered $73 million in operating income, or 2.5 percent of revenue in the quarter. For the first half of the year consumer delivered 3.5 percent operating income, which is good, consistent performance, and about where we would expect to see profitability in the business at this time.

Now, I'll turn it over to Brad Anderson to discuss results in our enterprise solutions business.

BRAD ANDERSON: Thanks, Brian, and good afternoon.

At the analyst meeting in June we discussed in detail the strategic reshaping of our enterprise portfolio, and the investments we were making to enhance our solutions, capabilities, and core processes.

Our differentiated strategy has two key areas of focus. The first is next generation computing solutions, and architectures that address key customer needs, solutions that are easy to implement and manage, that address physical and virtual management holistically, and extend adoption for key technologies, by packing the right functionality and the intelligence to drive ease of use.

The second key area of focus is intelligent data management, which is developing an architecture that unifies storage subsystems, both block and file, and offers advanced functionalities that can be used across them, across the data's lifecycle. By coupling our unified architecture with the intelligent policy engine, we can dramatically simplify and automate data movement and access while optimizing cost.

We are both developing and acquiring IP and capabilities to execute our strategic enterprise objectives, positioning ourselves in the high growth areas of the business, and enhancing our enterprise profitability. Some recent announced solutions and services include the Dell OpenStack cloud solution, which is the first available cloud solution offering based on the OpenStack platform. We are now the first vendor to have our servers in working environments with temperatures up to 113 degrees Fahrenheit. Unfortunately, like what we're seeing in Texas these days, and we announced a partnership with Cloudera to produce solutions that reduce the complexity and costs associated with Hadoop systems that process large amounts of data.

With respect to acquisitions, the acquisition of Force10 will accelerate our next generation computing and intelligent data management strategies, and greatly enhance the breadth of solutions we can provide for our data center customers. The Force10 products and IP are very well positioned, and the fastest growing segment of the data center networking. Force10's history of product innovation and technology leadership and data center networking is very complementary and very much aligned to our enterprise and network vision, which we are calling the Virtual Network Services Infrastructure, or VNSI for short.

VNSI enables change to happen at the speed of the business and specifically addresses a simpler, more open network environment that is easier to view, manage, and control and one that can scale for today's requirements, as well as into the future. A few of the Force10 solutions that exemplify the innovation and technology leadership include, the Z-Series family of switches, which is redefining the economics of price performance in switching, through dense, high performance switches that operate at lower power consumption and total cost. This platform is particularly appealing to the mid-market segment.

The innovative S-Series family of top of rack switches can host third party applications and enhance network services, at state of the art, low-latency for the most demanding applications. And finally, the E-Series chassis, which supports mission critical applications, increased networking availability and efficiency, again, at very much reduced power and cooling costs. We are on track, because of the discipline and integration approach. We are targeting to close this within the next two to three weeks.

Now, let me tell you something about the rest of the business. The benefits of our mid-market design focus are clearly evident in the success of EqualLogic and continues to be a highly profitable line of storage, and remains the leader in the iSCSI market. The launch of the Dell EqualLogic FS7500 during the quarter brings the first scale out NAS and unified storage capabilities to the Dell EqualLogic platform. The FS7500 provides up to 10 times more file share scalability than the legacy unified storage offerings in the marketplace today. It's the industry's only scale out solution optimized for mid-sized and smaller deployments.

Dell also announced its next generation Dell EqualLogic software, which includes enhanced enterprise class storage capabilities, and automated load balancing. This is the second solution we have introduced utilizing IP from the Exanet acquisition, and is another excellent example of our ability to effectively integrate acquired technologies into our portfolio.

Similar to the early results we saw in EqualLogic, we are already seeing very promising results for Compellent. Customers are clearly attracted to the fluid data architecture, as evident by our Q2 results. In its first full quarter after being acquired, revenue is up 97 percent sequentially. Our global sales team and partners have delivered a significant expansion across the regions as we sold Compellent in 47 countries in Q2 compared to only 30 in Q1.

In Q2 our total storage revenue declined 20 percent, but growth in Dell-owned IP continued to show strength, up 15 percent led by the SMB segment growing at 27 percent year over year. This ongoing change in mix of our storage portfolio to more Dell IP continues to benefit margins as gross margin percent has increased approximately 800 bps over the past 12 months, and trailing 12-month margin dollars are up over 16 percent year over year.

The server and networking business continues to benefit from a corporate refresh, and mid-market focus. Our server and networking revenue for the quarter increased 9 percent with SMB up 17 percent year over year. Much of the strength overall is driven by the continued push to virtualization. This continues to be a very important trend for our business, as it has created more opportunities in services and storage as our customers are looking for end-to-end solutions to support their virtualized environments.

While we're pleased with the progress we've made, and the results from this quarter, we have more to do and are even more excited about the opportunities that lie ahead.

Now, let me turn it back over to Brian.

BRIAN GLADDEN: Thanks, Brad.

Let's turn to the outlook. We're focused on delivering efficient IT solutions that provide both efficiency and flexibility for our customers and value for our shareholders. We believe this will align our business with large and faster growing markets, create a broader base of recurring revenue streams with higher profit potential, and reshape the P&L for the company.

We have made significant progress during the last 18 months, and we are absolutely committed to our strategy which is delivering growth in revenue, operating income and cash flow consistent with our long-term value creation framework. In addition, we've made great strides in optimizing our supply chain, and that has helped to make our core business more healthy, profitable, and competitive globally.

As a result of these combined efforts, we're raising our operating income growth expectations for FY '12 to 17 to 23 percent year over year versus our previous view of 12 to 18 percent. This total year outlook would be on top of last year's non-GAAP operating income growth of 40 percent, and would likely put our profitability performance inline with our long-term value creation targets.

On the revenue side, when we combine the strategic decisions to redirect resources from lower to higher value solutions with a demand environment that's become more uncertain, particularly in light of recent macroeconomic news, we're revising our FY '12 revenue outlook to 1 to 5 percent growth versus our previous view of 5 to 9 percent. For the third quarter, we see revenue roughly flat relative to our second quarter, which is inline with seasonality we've seen over the last two years.

As you've heard from us on many occasions, we're managing the business for the long-term. This is particularly relevant during periods of increased short-term volatility in the demand environment. Assuming global IT spending that's approximately 1.5 times GDP, we're committed to making the best decisions for our customer sand shareholders over time versus managing to a more variable short-term environment as the global economy heads towards a more sustained recovery.

We anticipate interest and other to be around $70 million in expense, and we expect our full-year tax rate to be between 21 and 23 percent. We're executing well on our strategy in an increasingly mixed demand environment, and we will continue to manage the business for operating income expansion while investing in our business for the long-term.

With that, I'll turn it over to Michael.

MICHAEL DELL: Thanks, Brian. We're pleased with our results in the first half, especially Enterprise Solutions and Services. Our sustained strong growth in operating profits, earnings per share, and cash flow demonstrate that our strategy is working well. Customers are validating our approach and continue to turn to Dell for productivity solutions regardless of the economic backdrop. And you will see us continue to identify opportunities in a disciplined way that will generate profitable growth.

We're excited about our pending acquisition of Force10 Networks, but we know that value is created not by acquiring companies, but rather by successfully integrating them, along with continued investments in research and development, and sales capabilities. It's early, but we're building a strong track record of successful integrations.

Both our organic and inorganic investments are being made with a mid-market design focus. This emphasis is driving more innovative thinking across our entire company, and aligns with the largest agents of growth, innovation, and thought leadership in our industry. When you think about iSCSI, industry standard servers, virtualization, social computing, and new collaboration tools, it all starts in the mid-market. This expansion of our capability and solutions is opening up a broader base of the nearly $3 trillion IT market. These are exciting times for our team, and our customer, and we look forward to continuing to update you on our strategic progress.

With that, let's now open it up for questions and answers.

ROB WILLIAMS: Thanks, Michael.

Just a quick reminder to everyone on the line, please limit your questions to one with one follow-up.

Kristin, can we have the first question.

OPERATOR: Yes, sir.

Ladies and gentlemen, we will now begin the question and answer portion of today's call. If you have a question, please press *1 on your telephone keypad. You will be announced prior to asking your question. If you would like to withdraw your question, press the # key.

One moment please for the first question.

We will take our first question from Brian Marshall with Gleacher & Company.

BRIAN MARSHALL: Great. Thanks, guys.

I was wondering if you could talk a little bit about the new revenue outlook, and with respect to the implications of the lower IT demand outlook out there relative to deemphasizing some of the lower-end margin businesses?

BRIAN GLADDEN: Yes, Brian. It's clear that the demand environment is weaker, and a bit more uncertain than what we had in our previous view. We highlighted the U.S. and sort of the developed countries as a driver there, especially the consumer business. I would also say that the U.S. Federal buying right now is a bit -- we see a lot of push outs of opportunities there, while the pipeline itself looks pretty good, the ability to close those has sort of slipped month to month as we move throughout the year.

The second element, obviously, is our continued work around deemphasizing lower value business, and I think that certainly is contributing, and results in a lower revenue growth for the company. I think that's net-net a good thing for us. Obviously contributing to profitability and it's something that we will continue as we work through the portfolio, and mixing the business to higher value products.

BRIAN MARSHALL: Okay, and having said, a quick clarification, on the SMB side it looks like your operating margins were down about 140 basis points sequentially. Can you talk a little bit about some of the puts and takes there? Thank you.

BRIAN GLADDEN: Yes. I think SMB in general was probably the strongest market we saw, as you look at the segments. It clearly had 5 percent year over year growth in revenue. Relatively stable margin environment for SMB, continue to mix the business up, and it's clearly a space where you would see us making investments and higher OPEX in the short-term ahead of some of the growth with some of the new solutions and mid-market focused products and services. So, that's the fundamental dynamic, a place where we're making some investments, and that's effecting the operating income in the short-term.

BRIAN MARSHALL: Great. Thank you.

OPERATOR: The next question is from Ben Reitzes with Barclays.

BEN REITZES: Could you just talk a little bit more about the gross margin environment, and what's baked into your outlook for the rest of the year? And, Brian, if you could reconcile those vendor settlements that were positive in the quarter, and whether those are recurring in nature as well?

BRIAN GLADDEN: Yes, Ben. Again, we say it all the time, we're focused on operating income. You're going to continue to see a change in the shape of the P&L as we mix more and more to higher value solutions and services. That's going to be a macro trend that we think will continue.

We clearly have seen good execution of the team in terms of overall margins. I think a lot of the things we've been talking about for a long time with the supply chain, the product portfolio, sales execution around pricing, good pricing environment still continue to be elements that drive the performance here. The component cost environment we saw in the quarter was relatively flat sequentially, which is clearly significantly less deflation than what we've seen over the last few quarters. So, I think the fact that margins continue to be relatively robust in the business, in that environment, we feel pretty good about that. We think it's a good proof point around our ability to sustain those margins and drive the mix of the business as we move forward.

As relates to the vendor settlements, I'm not going to get into specific details there. There's a couple of specific items there that we would have these from time to time, and in this case it just is material enough that we called it out in the quarter. But, there's not anything specific we'll provide here.

BEN REITZES: My follow up just on storage, the ongoing growth rate is well below what you have talked about long-term for your target, significantly in the double-digit range. How long of a ramp until we get there? I know you haven't broken out the revenue, but it looked like before Dell IP slowed a bit, too, in the quarter. So, how long until we get the growth rate in storage that you've been talking about to your analysts?

BRIAN GLADDEN: Yes, on the storage side, because of EMC being ramped down, we have kind of always taken the position that we think by the end of the year we're going to start being, again, accretive on our revenue growth. We're already seeing the double digits, obviously, in the Dell-branded IP. But, we've just got to work through the tail with EMC, and continue to be on a path that by the end of the year we should be in positive storage growth overall and continue to be in double-digits for our Dell IP.

BEN REITZES: Thank you very much.

OPERATOR: The next question is from Toni Sacconaghi, with Sanford Bernstein.

TONI SACCONAGHI: Thank you. I wanted to get your perspectives on operating expenses. I certainly appreciate the incremental investment that it takes to sell your own IP, some of the front-loading in sales and service. But, the magnitude of the operating expense increase over the last year is really significant. I mean your year-over-year revenues this quarter were up $124 million. Your enterprise revenues, which I appreciate may be driving that expanded OPEX, were up about $250 million. Yet, your OPEX was up $500 million. So, for $500 million in incremental OPEX you're getting net for the company an extra $100-plus million in revenue, and $250-plus million in enterprise. That certainly doesn't sound like a good short term trade.

So, perhaps you can explain a little bit about whether there's anything one-time, how much of the increased OPEX is related to the higher compensation levels on a year-over-year basis, and when we can expect this to flatten out as a percentage of revenue, or decline as a percentage of revenue? And I have a follow-up.

BRIAN GLADDEN: Yes, Toni. I think on your comment, we're not thinking about it as a short-term dynamic here. These are clearly longer-term investments that we're making to reshape the business. I think we're focused on operating income. We've talked about the fact that operating expense as a percentage of revenue is going to rise in the business.

All of the things we're investing in, all the acquisitions we're making are clearly in areas where OPEX is going to be a significantly higher percentage of revenue. And therefore, we've got to see gross margin expansions that go with that, but that's going to be a dynamic that will ultimately continue in the business. Recognize that we spend a lot of time talking about the revenue environment and what that means. And you may see us in some areas make some decisions to slow down investments, strategic investments as we look at the environment. But, we're committed to the long-term transformation.

Some of the things I'll highlight that really contribute to the growth. We've talked about sales specialists around enterprise products. They now represent about 30 percent of our selling cost. We added in this quarter alone over 2,000 growth-oriented resources that are focused on R&D, as well as selling these kinds of products and solutions. I'd also highlight the fact that G&A is generally down in the business, and we continue to manage this pretty tightly.

There's one other thing I'd call out, obviously as you think about the profit that we have delivered in the first half of the year, we would also have relatively significant sequential impact from higher incentive-based compensation. So, a bonus plan in the business that's tied to higher profitability that we've seen in the first half of the year. So, those are kind of the dynamics. It's a deliberate set of investments that we're driving, and it's a long-term transformation that ultimately we're enabling here.

TONI SACCONAGHI: And where along that path of investments are you? So, perhaps you can quantify the year-over-year impact of the incentive-based comp, and whether you think that will continue in the second half. And then where on that path are you, because certainly you've front-loaded the expense and so should we continue to expect that second half OPEX expense will continue to increase from levels seen in Q2?

BRIAN GLADDEN: Again, I think we are watching the demand environment, Toni. And I think as we look at that and specifically execute on these longer-term investments, there are some places where we'll maybe slow down and clearly make some decisions to manage through some of that short-term dynamic. I think the simple answer is we're going to continue to make the long-term investments. And I think you'll see us as we look at that second half operating income outlook that we provided to you, make the appropriate tradeoffs there between cost, based on the revenue environment that we see. And we feel confident with that 17 to 23 percent in the environment that we see that we can make those tradeoffs and deliver that commitment.

OPERATOR: The next question is from Maynard Um with UBS.

MAYNARD UM: Hi, thanks. Dell has typically had pretty good visibility to down and upturns given your direct business. Can you just talk about whether you started seeing that at the end of the quarter, whether that intensified into August, just kind of the timelines?

BRIAN GLADDEN: Yes, Maynard. We're saying third quarter feels like flat. I think that's pretty consistent with what we've seen over the last couple of years, in terms of sequential dynamics. I would say that we saw some weakening in parts of the market in the second half of the quarter that I would say we've seen continue. That would be the things we highlighted, the U.S. consumer market clearly, the federal business, again, there are some opportunities there, but I think the question is how much of that gets closed out before the end of the fiscal year within the federal government. So, it's clearly been a bit softer in the last few weeks and obviously we're monitoring that throughout the quarter.

MAYNARD UM: Secondly, I just wanted to follow up on the question of OPEX. It sounds like you're incrementally -- obviously incrementally more concerned here on the macro side. And I'm wondering if your OPEX, or the way you've thought about OPEX -- obviously you're going to continue to invest, but has that changed relative to the revenues, or is this still the original plan on the lower revenues, thanks?

BRIAN GLADDEN: I think we're committed to the plan, in terms of reshaping the business. I think given the dynamics we're seeing from a demand standpoint in the marketplace, we're re-looking at some of the timelines around some of those investments. And I think it may mean a little bit different timeline in some of that. But, I think in general you'll see us continue to make those investments. There are other areas within the business where we've consistently been reducing OPEX spending to enable some of that funding. And we'll continue to drive those activities, as well.

OPERATOR: The next question is from Richard Gardner, with Citigroup.

RICHARD GARDNER: Yes, Brian, I was hoping you could give us an update on your plans for share repurchase in the back half of the year, given that you did so much in the second quarter.

BRIAN GLADDEN: Yes, Richard, I wouldn't say anything different than what we said at the analyst meeting, I think. I mean we're committed to this longer-term outlook of 10 to 30 percent of free cash flow. Free cash flow is pretty good. So, that obviously gives us a little bit of more opportunity here. We are committed to the strategic investments that will continue to be a use of cash. And we would expect the second half of the year, as we said at the analyst meeting, to return to more of a normal level consistent with what we had prior.

RICHARD GARDNER: The price of the stock is obviously pretty attractive here. So, it sounds like you do continue to have plans to buy back stock in the back half of the year, but maybe not at the Q2 level. Is that the right way to think about it?

BRIAN GLADDEN: Yes, we'll continue to look at it. We're committed to continuing the program, and that's sort for the current view.

RICHARD GARDNER: Okay. And since everybody else is asking a follow-up, I guess I'll just ask a follow-up on the health of the corporate upgrade cycle. You talked about incremental weakness in U.S. consumer and federal. Are there other areas where you've seen a little bit of incremental caution or weakness here in recent weeks?

BRIAN GLADDEN: Maybe we'll let Michael comment as well, but I think in terms of corporate demand between SMB and large enterprise has continued to be pretty solid. Those programs are multi-quarter, multiyear programs that generally refresh and upgrade around servers as well as clients, and most of those activities continue. We're not seeing significant disruption there, if Michael can add a comment.

MICHAEL DELL: Yes, that's right. I mean, the demand has been pretty steady, as Brian said, the upgrade programs that companies have tend to be multi-quarter, and we haven't seen significant change in those.

RICHARD GARDNER: Thank you.

OPERATOR: Next question is with Shannon Cross with Cross Research.

SHANNON CROSS: Thank you for taking my question. My first question is just on the Google Motorola acquisition, Michael, if you could talk a little bit about your thoughts on how this might change your strategy, or how you see it changing the mobile landscape?

MICHAEL DELL: Well, you know, it's sort of early to say, because I don't think Google has -- they obviously haven't finished the transaction, and they haven't said a whole lot about it. But I think certainly patents play a big role here, and having Android with a stronger ability to exhaust patent claims against it probably sets up an interesting competitive dynamic. We're still quite interested in Android. I will also tell you that our early work on Windows 8 on the tablet side looks to be pretty encouraging. And so, you know, we think it's shifting up to be a competitive environment.

I don't think beyond those two that there are viable alternatives that make sense. So, there's a lot of other noise out there in the market, but I don't think it will amount to much of anything.

SHANNON CROSS: Okay, great.

And then, Brian, if you could talk a little bit on the cash flow side, just any more color you can give us on the driver during the quarter, anything that might reverse itself in coming quarters, again, given the strength this quarter? Thank you.

BRIAN GLADDEN: Yes, Shannon. I think pretty solid cash performance. I mean, when you look at the underlying cash earnings are very strong. One of the elements you see is real strength in our services deferred revenue balance where we built that, that's 11 percent year over year. That bodes well for the future. And obviously contributes cash in the short-term. The cash conversion cycle, as we've said consistently, we think the mid negative 30s is the range that we're in, and we think that's pretty sustainable. So, feel pretty good about the cash flow, and its sustainability.

SHANNON CROSS: Great. Thank you.

OPERATOR: Our next question is from Brian Alexander with Raymond James.

BRIAN ALEXANDER: Yes. I guess going back to the OPEX issue, have the hires you've made over the last 12 months generated the productivity results that you expected, and how do you measure that so that you can get comfortable that these investments are generating appropriate returns, and when should we expect to see a noticeable acceleration in our top line growth, which obviously you would expect in making these investments? Thanks.

BRIAN GLADDEN: Brian, it's clearly something that we're tracking very, very closely. And I think one of the things that I think is new and different is really having dedicated resources that are aligned with specific solutions and, therefore, our ability to track closely the progress we're making, and the productivity we're getting from those incremental resources.

So, I would tell you, without providing obviously a lot of data there, that we feel good about that. In many cases, we have gates, and the ability to modulate the pace at which we hire based on how that productivity is playing out, and how the solutions are growing. And it's absolutely clear that there are many cases where we're investing this OPEX ahead of the revenue and the margin that's going to come with it. One of the dynamics is, you look at some of the areas where we're growing quickly today, whether you look at KACE, whether you look at Compellent, whether you look at EqualLogic, these are all areas that have significant services attached, and very high margin attached services that ends up in deferred revenue. So, that ends up being a nice annuity for the businesses we've moved forward, and it looks like in the short-term like a big OPEX investment without a lot of payoff. So, I think you'd see that's one of the key elements that drives an 11 percent increase in the deferred balance is a lot of these acquisitions and new technologies are ultimately contributing to that.

BRIAN ALEXANDER: Okay, thanks. And just a follow-up, how much of a drag on growth is the pruning that you talked about having? How much of that is depressing your top line of the quarter, and for our full year outlook of 1 to 5 percent growth?

BRIAN GLADDEN: I think it' a tough question to answer. There are specific areas we can highlight, whether it's obviously the EMC wind down, whether it's specific software reseller agreements that we've walked away from as a result of margins, those are much easier to quantify, and those are significant. You know, obviously, we could put numbers on that of over a billion dollars clearly associated with those activities.

And then there's a more subjective area where you have transactions and deals that you are choosing not to participate in, which is incremental to that. So, if it's a couple of points on the total revenue, that wouldn't be surprising. It could be even more than that.

BRIAN ALEXANDER: Okay. Thanks so much.

OPERATOR: The next question is from Bill Shope with Goldman Sachs.

BILL SHOPE: Okay, great. Thanks, guys.

Can you give us some color on what you're seeing in terms of the competitive pricing environment, particularly in the client business? And as you look into the second half, how are you thinking about ht pricing environment, particularly given what you're seeing with demand conditions right now?

BRIAN GLADDEN: Bill, I think the gross margins continue to be relatively stable, and we feel pretty good about how that overall equation is playing out with component prices versus the overall pricing environment. I think in general pricing has been relatively benign around the client business. And that has continued for a few quarters now.

As we look going forward, that's obviously one of the areas where we would continue to monitor the dynamics of the marketplace, and react accordingly. But clearly it's been relatively benign when compared to historical sort of trends.

BILL SHOPE: Okay, great. Thank you.

OPERATOR: The next question is from Katy Huberty with Morgan Stanley.

KATY HUBERTY: Thanks. Good afternoon.

Just a follow-up to the question on pricing, Brian. There's a comment in the slide deck about increased competition in large commercial accounts. Does that have to do with pricing competition in large commercial accounts, or is that just a change in the financing business?

BRIAN GLADDEN: Katy, I think your comment is actually on a slide for the DFS business, for Dell Financial Services.

KATY HUBERTY: Right. I guess that's a question. Was it a change in pricing competition, or just a change in competition around financing in those accounts?

BRIAN GLADDEN: It was specific to the Dell Financial Services, kind of large enterprise originations, and clearly some different dynamics that are playing out with, in some cases, banks, for instance, becoming competitive in some of those transactions that I guess we would call out as the primary driver there.

KATY HUBERTY: Okay. Got it. And then, just a quick follow-up, obviously a few questions about OPEX, and it's clear what the strategy is. But as you think near-term with revenues flat into the third quarter, would you expect OPEX to be flat sequentially, or with higher bonuses does OPEX come up again in the third quarter?

BRIAN GLADDEN: You know, I'm not going to get into the quarterly guidance at that level, Katy. I mean, I think we'll continue to monitor the demand environment, and we're making the appropriate adjustments to the OPEX spend as we kind of move forward based on the environment. So, I think within the context of the operating income guidance we provided, I think we'll let you think about that.

KATY HUBERTY: Thanks.

OPERATOR: The next question is from Keith Bachman with Bank of Montreal.

KEITH BACHMAN: Hi, Brian. I wanted to ask you a question about the year over year guidance, and what it implies for the January quarter. It looks like to be above more than 1 percent kind of annual growth, you need a seasonal bump in the January quarter of something like 4 to 5 percent. But I was just hoping you could perhaps give some color at least on what you're seeing today on what you're thinking about the seasonality for the January quarter? I assume the consumer would be fairly weak, but the commercial side sounds like it continues to be strong. Could you give any color on how you're thinking about the seasonality in January, and then I have a follow-up, please.

BRIAN GLADDEN: I think some of those comments are fair. I think personal demand continues to be kind of a key driver that we're counting on being relatively stable. As we've said, there's really two areas that we're monitoring closely that will have a big impact there, and it's the consumer business and how that plays out. That would be a typical driver of seasonal pick up third quarter to fourth quarter for us. And we're counting on some of that, obviously, in this case, off of a lower third quarter, obviously. And then the overall kind of public spend, I think those are the things that we'll watch.

KEITH BACHMAN: So, is mid-single digits sequential growth a reasonable place to start for the January quarter?

BRIAN GLADDEN: Yes, I mean I think that's the way we're thinking about it and it's fairly easy to back into that, based on the way we're providing the outlook now.

KEITH BACHMAN: Okay, fair enough. Then my follow-up is on services. You had very strong sequential growth in backlog. And it looks like a lot of the growth was in contracted services. And I think you highlighted in your prepared remarks that that might have some impact on margins for services in particular. So, I was hoping you could just give us some color as you look out over the next couple of quarters; will services margins be flatish, up, or down?

BRIAN GLADDEN: I mean I think that there's always a cycle of new contract signings happening, right. And there's always, therefore, the impact on margins of those up front investments you need to make to get those contracts up and running. So, look, I think in general I wouldn't call that out as a pressure that we're going to say we have in the next few quarters here. We're going to have other contracts that we signed two years ago that are hitting their stride and improving in terms of the margins, so I think that cycle always continues and we'll manage our way through it. I don't have any specific call outs on why services margins would dramatically change, other than the fact that we're trying to grow the business and mix the business up.

KEITH BACHMAN: Okay, fair enough. Thanks very much.

OPERATOR: Our next question is from Chris Whitmore with Deutsche Bank.

CHRIS WHITMORE: Thanks very much. I wanted to follow up on the margin question one more time. Your guidance seems to imply that back half margins, operating margins I'm speaking about, will be similar in the 7 percent range, low 7 range, versus the 8.5 you just reported. Is that decline expected to be more on the gross profit line, or the operating margin line?

BRIAN GLADDEN: Well, again, we're not going to provide that level of granularity in the outlook. I think we're intentionally giving you operating income, because that dynamic is going to change over time. And I think we want to stay out of that discussion. I think what you'll see is, that's our outlook based on the market conditions we see now, and the uncertainty. And as we move forward and get through the third quarter we'll obviously update you at that time. And I think we're reshaping the P&L over time. And we need kind of the flexibility to do that and not get into here's what the gross margin is going to be versus here is what the OPEX is going to be in a quarter.

CHRIS WHITMORE: My follow up, I want to go back to the demand environment on the corporate side of your business. And I'm just trying to reconcile your comments around steady demand with decelerating revenue growth against easier compares in both the enterprise business and the S&P business. Help me understand why you're seeing slowing year-on-year growth, yet characterize the business as being healthy. Thanks.

BRIAN GLADDEN: I think you've got to break it into pieces here. And clearly, as you look at the second quarter results, we saw server growth at 9 percent. We saw the Dell storage business at 15 percent growth, which is the Dell technologies. We saw the services business at 6 percent. So, there are clearly some areas where we're seeing relatively strong growth. I would also highlight the growth markets, and specifically India and China continue to be growing in greater than 20 percent of the quarter, and we expect that to continue.

As you look at overall dynamics of the P&L, those are clearly important areas where we're making investments, but we're seeing very strong margins that come with that. As you think about the second half, we would expect those to continue. And I think that's where we say that there's relatively good stability and I would just say that specifically client refresh activity in the corporate environment continues.

So, those are areas that we're counting on to be relatively stable. I think there's others that we called out quite a few times on the call here that we think are a bit weaker, and consumer is clearly one of those.

CHRIS WHITMORE: Thanks a lot.

OPERATOR: The next question is from Mark Moskowitz with JP Morgan.

MARK MOSKOWITZ: Yes, thank you. Good afternoon. Brian, I want to see if you can come back to the public sector for a moment here. You talked about your total server revenue growth around 9 percent. Can you give us some context around what the public grew? I know you talked about client revenue being up 34 percent sequentially, but I'm just trying to get a sense in terms of what drove the public out-performance in terms of operating margin, whereas the other segments were down sequentially in operating margin. Was it server or storage being much bigger than expected, because of maybe a pre-budget flush ahead of some of the government challenges out there?

BRIAN GLADDEN: I wouldn't say that. We can let Brad comment on the dynamics you're seeing in public around some of those products, and then maybe I can talk about the P&L movement.

BRAD ANDERSON: Yes, on the public side we didn't see a big spike in server revenue growth on the public side. So, it was less than 9 percent.

BRIAN GLADDEN: Yes, slightly less than 9.

BRAD ANDERSON: Yes, slightly less than 9, it was reasonable. I mean where we see most of the server growth was in the SMB segment, and then particularly it was incredibly strong in the Asian market.

BRIAN GLADDEN: Yes, I think the total P&L discussion from a sequential standpoint is really about nice leverage in the P&L. I mean, we saw nice overall revenue growth in that part of the business, tied to the U.S. federal, or the state and local kind of timing. We saw good solid growth in both education and healthcare. And I think as you think about that, that just contributed on a relatively good cost environment, it's a good leverage in the P&L report.

MARK MOSKOWITZ: Okay, thank you. And then the follow up is around the growth markets commentary, you talked about the growth being around 17 percent year-over-year. That did decelerate versus the prior quarter. I'm trying to get a sense, in terms of what does that mean going forward here. I know we have some pretty big numbers here, year-over-year, for growth markets. But, going from 17 percent growth down to 14 percent, are we going to single digits now next quarter, in terms of year-over-year growth in growth markets? And what are the drivers there?

BRIAN GLADDEN: Well, I think we highlighted two of the drivers. Clearly, India and China continue to be for us relatively strong. And we would expect that that will continue. I think there are a couple of other places where you're seeing a little bit tougher compares and maybe less growth. I mean Brazil is an example where you probably saw mid-single digit growth in the quarter, and we think that's still a great market that has less growth potential. So, we're still bullish on the growth countries playing a big role for us and continuing to grow at double-digit rates for sure.

MARK MOSKOWITZ: Thank you.

OPERATOR: The next question is from Aaron Rakers at Stifel Nicolaus.

AARON RAKERS: Yes. Thanks, guys, for taking the questions. Most of them have been asked and answered, but I want to go back to the storage piece of the business. Obviously you guys are folding in Compellent into this quarter. I know you guys reported 15 percent growth X EMC. But just from a math perspective, it looks like that would imply pretty sharp deceleration in the EqualLogic business organically. Can you talk a little bit about what the trend is specifically within EqualLogic, and what you might be seeing from a competitive landscape perspective?

BRAD ANDERSON: A couple of things. One is, we still see EqualLogic still is the iSCSI leader, and we still see strong demand for the Dell IP. What we did see in the quarter was, we had a little bit of headwind where we had to recall a vendor, a second tier supplier, so we had a little bit of supply chain hiccup. We have done that, so that kind of provided a little bit of headwind. And then probably the other headwind was, we just announced and we're starting to ship actually this week, the next generation EqualLogic controller, and new software, and so I think we saw a little bit of waiting for the brand new hardware to come out this week. So, I think the combination of those two things probably dampened it a little bit. Of course, those are now completely behind us, and so the supply chain thing has been completely rectified, and we are now in a position to ship the new products. So, I see us being a little bit more balanced going into Q3.

AARON RAKERS: And then the follow-up question from me would be on the server side. How are you thinking about relative to your current guidance the server and networking growth, in particular I think there's been a lot of questions thrown around, around obviously sitting in front of a transitional cycle from Intel platforms. How are you thinking about that cycle, are you factoring in any pause in front of that potential product cycle?

BRAD ANDERSON: The actual launch of the next Intel platform is not yet real obvious, or clear as far as the timing. So, I think we're still seeing kind of the server refresh cycle continue. This is, I think, the seventh quarter of positive growth. We're still seeing those configurations be rich, which is really helping the ASPs. In fact, ASPs continue to trend up year over year whereas the historical trend has always been down. I think this is, again, probably the fifth or sixth period where we've had trending up ASPs. So, it continues to be pretty reasonable, and I would expect it to continue over the next quarter.

AARON RAKERS: Thank you.

OPERATOR: The final question today is from Abhey Lambda with ISI Group.

ABHEY LAMBDA: Thanks. Brian, I think the consumer was weak when you last gave guidance as well, so have you seen things deteriorate since then, or were you expecting some pick up that is not coming in?

BRIAN GLADDEN: I guess it's hard to answer it that way, but it's clearly been -- we saw some weakness in the second half of the quarter relative to what we were expecting coming into the quarter. So, in that sense it has been weaker.

ABHEY LAMBDA: Got it. And once you complete the Force10 acquisition, should we expect a similar impact on the networking business as we are seeing with storage, where EMC is going down faster than the growth in other sales?

BRIAN GLADDEN: I'll let Brad talk to that, but there clearly will be a similar dynamic where low margin revenue today we have where we're reselling networking products will be replaced by Dell technology that has significantly higher margins.

BRAD ANDERSON: Brian is absolutely right. The big difference here is that we didn't resell any particular network vendor anywhere near the scale of EMC. And so, there's less of a trough, if you will, or that gets emptied, but we clearly are going to drive Dell branded IP, so we are really excited about the Force10 product. It's leading technology. It's extremely complementary. We'll continue to sell some other products to kind of complement the portfolio, but where we now have leading industry IP, we're going to sell the Dell branded.

BRIAN GLADDEN: Before we wrap up let me just make one statement. I think clearly lots of proof points in the financial performance, and really even when you look at it over the last year around our strategy and the investments that we're making. When you look at it over the last four quarters we've delivered $2.07 of non-GAAP earnings per share, which is up 83 percent over the same period we've delivered a GAAP operating income level of 7.3 percent, which is actually over our long-term value creation framework.

We have improved gross margins by 600 basis points from a year ago and held them relatively steady over some different component environments. We've also added over 300 basis points of OPEX, as we've discussed on the call here, and we would say that all of that is deliberate in critical strategic areas, that we've been incredibly transparent about.

So, the P&L has changed pretty dramatically, consistent with really what we said we were going to do. And on top of that we generated 5.2 billion of cash flow from operations over the last year. So, a lot of great proof points in terms of the progress we're making and we look forward to continuing to do that.

ROB WILLIAMS: Great. Thanks everyone. We'll speak to you soon.

OPERATOR: This concludes today's conference call. We appreciate your participation. You may disconnect at this time.

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