

DELL, INCORPORATED

Moderator: Lynn Tyson
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Operator:

Good afternoon and welcome to the Dell, Incorporated second quarter fiscal year 2009 earnings conference call and strategy update. I'd like to inform all participants, this call is being recorded at the request of Dell. This broadcast is the copyrighted material of Dell, Incorporated. Any rebroadcast of this information in whole or part without the prior written permission of Dell, Incorporated is prohibited. 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 Miss Lynn A. Tyson, Vice President of Investor Relations. Miss Tyson, you may begin.

Lynn Tyson:

Thank you.

With me today are Chairman and CEO, Michael Dell and Senior Vice President and CFO Brian Gladden.

Brian will review our second quarter results and the progress we've made on our cost initiatives and then Michael will follow up with his perspective on our enterprise portfolio and then we'll move to Q&A.

Please make sure to review our web deck on Dell.com/investor for additional information on our

results and I'd also like to point out that we have expanded the disclosure in our cash flow table. References we make on this call to dell's unit growth as a multiple of the industry growth excludes Dell and all growth rates are year over year, unless otherwise noted.

Our IR calendar for the balance of the year includes Michael Dell at CitiGroup next week and Mike will also be at CSFB in December and then Brian will be at BofA next month.

Finally, I'd like to remind you that all statements made during this call that relate to future results and events are forward looking statements that are based on our current expectations. Actual results 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 Web site.

I'd now like to turn the call over the Brian.

Brian Gladden:

Thanks, Lynn. When I joined Dell three months ago I had a view of the fundamental advantages of this company, as well as opportunities for improvement. On the advantages side, our products and solutions portfolio was well aligned with the growth opportunities we see in technology. We have an increasingly large broad based share presence around the world which translates to more customers and the ability to expand the products and solutions we sell to them. We have superior cash generation capability and we have an engaged and experienced leadership team.

On the opportunity side, we can improve our global competitiveness which includes our total cost structure, we can improve the consistency of our execution across all aspects of the business, and we can improve our return on capital.

Our performance this quarter really highlights these advantages as well as the areas where we still have much work to do. Our current focus to grow faster than the industry in the five key areas of global consumer, enterprise, notebooks, SMB, and emerging countries enabled by improvements in our competitiveness will drive improving growth in earnings and cash returns for our shareholders over the long term.

So, let me turn to the quarter. We had a great growth quarter in this quarter as we generated \$16.4 billion in revenue. As an 11 percent increase on a 19 percent increase in units. Growing at 1.4 times the industry, we gained share in all major product categories and in all major

regions. Gaining one full point of share globally. We displayed particular strength in notebook and server units which were up 44 and 19 percent respectively.

On a regional basis, unit growth was fueled by a 53 percent increase in units in our global consumer business and in BRIC countries, where a major portion of the industry growth will come from in the next five years, revenue was up 41 percent on a 46 percent increase in units. This was more than three times the rate of the industry, driving a two point four point share increase for the region.

Our revenue mix for brick countries is now over nine percent of our revenue and our revenue outside of the U.S. is 47 percent of our total mix. Our global commercial business was approximately 80 percent of our unit and revenue mix for the quarter. We know we can improve our performance on profitability as operating income was \$819 million or five percent of revenue. Margins declined sequentially, driven by a decline in gross margin rate, which was partially offset by an improvement in operating expenses.

Let me spend a minute on the dynamics on this line as I know many of you are concerned that our growth initiatives will come at the expense of long term profitability. As I mentioned earlier, our goal is to improve earnings over time and this will be driven in part by an optimum balance of revenue growth and improvement in operating profit. Gross margins declined sequentially by 120 basis points, as we took strategic pricing actions in EMEA ahead of cost improvements. In EMEA, we also had an increase in the deferral of service revenue driven by changes in how we market our service offerings in the region. While this had a negative impact on reported profit in the quarter, it was neutral to cash and the revenue and profit will be recognized in future periods.

Gross margins were also impacted by the retail mix shift in our consumer business as we continue to expand our global footprint in this business. The sequential decline in gross margin was partially offset by a 70 basis point sequential decline in OpEx, or 160 basis points year over year, reflecting some of the strong progress we've made towards our \$3 billion in cost initiatives.

As we've mentioned in the past, I think over the next several quarters you'll continue to see some nonlinearity in the improvement in our operating income margins as we rebalance our portfolio, harvest cost improvements and drive growth. As I'll talk about in a few minutes, we have clear line of sight to the \$3 billion in cost opportunities and I think you will start to see them manifest themselves more in the back half of this fiscal year.

Excluding the impact of acquisitions, our headcount was down 8,500 since the Q1 of last year,

which was when we shared our target of 8,900 with you. We'll effectively reach our goal this quarter. On a sequential basis, headcount was down about 1,500 people. Over time, we'll continue to improve productivity and scale our headcount as we grow.

In the quarter, we absorbed \$27 million of expense for the amortization of purchase intangibles and \$25 million in business realignment costs. They were each worth about one penny.

Our tax rate was 26.4 percent, reflecting a 290 basis point increase versus last quarter. The increase in the rate was primarily driven by a shift in the mix of our income, the higher tax rate jurisdictions.

Earnings per share were 31 cents and cash flow from operations was \$1.1 billion. Our ability to generate cash remains robust, evidenced by our trailing four quarter cash flow from operations of \$3.4 billion, or \$1.61 per share.

On an annualized basis, we believe we'll continue to generate cash flow from operations in excess of net income. We ended the quarter with \$9.5 billion in cash investments and in the quarter, we spent \$1.4 billion to buy back 60 million shares. This helped to drive our weighted average share count to two billion shares, which is over an 11% reduction from Q2 of last year. About \$5 billion remains in our current share repurchase authorization and we expect to use a portion of this authorization in the second half of this fiscal year. Our cash conversion cycle was negative 29 days and we believe for this year it will be generally in the negative 30 day range and our return on total capital was 33 percent.

So now let me turn to an overview of our regional and product performance. In our America's commercial business, we're the number one provider of systems in the region and our revenue increased five percent to \$8.1 billion on a seven percent increase in units. While operating income dollars were down year over year, the region improved profitability sequentially by almost 20 percent, reflecting balanced growth across products and regions.

Servers shipment growth of 18 percent was against a backdrop of no growth in the industry, garnering us three points a share in the X86 space. Our share in servers now stands at 37.8 percent.

Mobility growth was up 12 percent, roughly in line with the industry.

In EMEA commercial, revenue was up 11 percent to \$3.5 billion on a 20 percent increase in units. Operating income declined on a year over year and sequential basis.

As I mentioned in the gross margin discussion, in the quarter we took advantage of some strategic growth opportunities in advance of cost improvements and we had a larger than usual accrual for deferred services.

We're confident that our focus in expanding our footprint in this region will yield sustained improvement and profitability in the future as we improve our mix of products and services and realize cost improvements.

Server units in the region were up 18 percent, the fastest growth among the top five vendors and almost 1.6 times the rate of the industry.

Growth in notebooks also outpaced the industry with a 52 percent increase in units. And from a country perspective, we experienced double digit unit growth in the U.K., France and Germany.

In APJ commercial, revenue was up 16 percent to just over \$2 billion, on a 16 percent increase in units and operating income was up more than 10 percent year over year.

Growth and profitability were driven by a very balanced mix of country, segment and product performance as our share in this region increased by 1.7 points.

Our growth in total units was over three times the rate of the industry as we strengthened our position as the second largest provider of servers in the region.

Global consumer revenue was up 28 percent to \$2.8 billion on a 53 percent increase in units. Which was over twice the rate of the industry and driven by a better than 100 percent increase in notebooks.

Profitability was roughly break even as the business expanded its retail presence and absorbed a litigation expense of \$18 million in the quarter.

On the product front, revenue from mobility products was up 26 percent on a 44 percent increase in units, which was at a premium to the industry. The growth in mobility was driven by our expansion in consumer and also the layering in of a 50 percent increase in notebook platforms this year. We also grew at a premium to the industry in desktops, which were up five percent in

terms of units.

Growth in enterprise products and services, which Michael will talk more about later, accelerated nicely in the quarter. Server revenue was up five percent on a 19 percent increase in units, or almost three times the rate of the industry. Our X86 server share grew by three points as we strengthened our position as the number two vendor in the world and we significantly outperformed our main competitors in all major regions.

Growth in the quarter was aided by the success of our cloud computing initiatives, these Dell custom solutions are built around web 2.0 technologies and now power, among other organizations, three of the top four search engines in the U.S. Over time, these solutions will drag an increasing amount of Dell services and software.

Storage revenue was up 11 percent in the quarter. This growth which yielded improved profitability was fueled by our power ball disc products and EqualLogic iSCSI network storage solutions.

Enhanced services revenue was up 14 percent to \$1.5 billion, driven by an 18 percent increase in our support services, which deliver customizable support solutions for end users and IT professionals in Dell and non-Dell environments. Our deferred revenue balance grew 22 percent, or by \$1 billion, year over year, driven by the growth in as sold services.

Software and peripherals revenue grew 17 percent with improving profitability. This is the fourth consecutive quarter of double digit growth for our S&P business. This product category enjoyed gains across all of our regions fueled by our acquisition of ASAP and improved performance in our displays business where we regained our number one worldwide position in flat panel displays.

Before turning to the outlook, let me briefly go over some of the progress we've made on the \$3 billion in cost initiatives announced earlier this year. As you know, these initiatives cover three large areas. How we design and price our products, OpEx and finally manufacturing and logistics. I now lead the bi-weekly global planning an interlock sessions where we reviewed detailed score cards and tracking models that identify and calendarize the opportunities. We also have tracking metrics to quantify how these opportunities flow through the business. Let me give you a few examples.

On the product design and pricing front, which largely sits in cost of goods sold, or COGS, as

you know, we're designing cost optimized products with more competitive features. This is a two part process.

First, we're designing products with features customers want and are willing to pay for. We're eliminating the complexity and features our customers did not value and are adding more features that they do value. We call this designing to value, pricing to value, and selling to value.

A recent example is our Vostro 1510 notebook design for our SMP customers. This product is cost advantaged versus its predecessor as we used more industry standard materials for the chassis and we also optimized feature sets specifically for our SMP customers versus leveraging feature sets from our consumer business.

The second part of the process is how we approach our procurement process. We now have a clean sheet approach that identifies process and material procurement inefficiencies. These opportunities are independent of the typical decline in component costs that we see. When you take this approach to product design, and the pricing and products and apply it to every single unit we sell, it yields a tremendous opportunity for us that accrues to the P&L as we grow our business and launch new products.

Turning to OpEx, we've made significant progress and are at our lowest dollar level in over one year. This improvement was aided by a reduction in headcount of 8,500 as we made over the last 14 months, which helped drive our revenue per employee up by 24 percent. And as part of our global initiative to improve sales execution and coverage through better alignment with customers, we made investments in front line or customer facing capability. Over the last six quarters we increased the percentage of front line personnel considerably from 54 percent to 62 percent of our people.

On an ongoing basis, we'll invest in strategic growth areas while scaling expenses and improving productivity.

And lastly in manufacturing and logistics, which is the smallest on a dollar basis of the three cost initiatives, we've improved efficiencies by consolidating some of the company owned sites in the U.S. and Canada and we continue to review our global manufacturing network to ensure we have an optimized structure.

To summarize, we've made significant progress on our cost initiatives and are confident in our

ability to hit our target of \$3 billion by the end of our fiscal 2011. No doubt there is much more work to do and we're vigorously pursuing those opportunities, though some of these initiatives will show results sooner than others.

Now, before I turn it over to Michael, let me give you some perspectives to think about relative to our performance for the balance of the year. First, we'll continue to incur costs as we realign our business to improve competitiveness, reduce headcount in certain areas and invest in infrastructure and acquisitions.

Second, we see continued conservatism in IT spending in the U.S. which is extended, to some extent, in Western Europe and in certain countries in Asia. Changes in currency rates could also affect the demand environment and our results.

Third, we continue to benefit from improving performance in areas like emerging countries, notebooks, enterprise and services, which collectively are driving a more diversified portfolio of geographies and products.

And fourth, we're working aggressively on our cost initiatives, which overtime will benefit our P&L with improved growth, profitability, and cash flow.

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

Michael Dell:

Thank you, Brian. Let me start by saying that I'm pleased with our broadcasted growth, especially in the global commercial business. Over the past year, this business has generated about \$53 billion in revenue and \$3.7 billion in operating income and we've been the number one provider of commercial systems worldwide for eight years running.

Looking at the IT industry as a whole, in four years global IT spending, which includes services, labor, and hardware will approach 1.5 trillion. The lack of innovation in two thirds of this spending, specifically services and labor is robbing resources from IT – from customer's IT spending. We're making investments that will enable us to participate more broadly in that two thirds, but in a very distinctive and disruptive way.

Our goal is to enable flexibility, configurability, access to industry leading innovation and value by leveraging technology arbitrage versus labor based services. To address this opportunity, we're deploying an expanded solutions portfolio to be an organic growth and with acquisitions.

I spend a fair amount of my time with commercial customers around the world and there's no doubt that they believe we have the strongest solutions portfolio in our history from client products through the servers, storage and services. Our growth in the enterprise this quarter is evidence that we are now in the consideration set by more customers – by more current customers and existing customers are turning to us to provide more robust offerings at an increasing rate.

So, let me give you two examples of how we partnered with our customers to provide them with differentiated customized solutions to help simplify their environments.

The first is sales force stock op. Here we recently won a very large opportunity for our enterprise hardware and services that essentially replaces a proprietary UNIX system from a key competitor, resulting in significantly lower costs and an easier to manage environment for the customer. The creation of this solution involved collaboration across our enterprise sales organization, high availability database and custom engineering teams and our pro support services teams.

We'll bring up a new data cent for them in Singapore that will run entirely on Dell from the start and our teams are collaborating with sales force to support the multivendor hardware and software stack that they require. Their U.S. production data centers, they're currently adding new data bases or going on Dell, and those will migrate to Dell over time with the existing data bases.

The second example is that of a very large global retailer where our advanced systems group partner with onsite systems engineering, virtualization experts and sales teams to create a very large virtualized infrastructure solution that includes remote access, flexible computing platform based on our PowerEdge servers, 10 gigabit Ethernet switches, EqualLogic SAN's, VMware virtualization and Citrix Xen desktop as a connection to the virtual cloud. All of this is supported by our enterprise services teams providing support desk operational expertise, open managed systems management monitoring and ongoing customer training. This is a solution that we could not have offered to this customer 18 months ago.

Two other areas of rapid growth for Dell in the solutions area are data center consolidation including blades, where we recently launched our power edge four socket M905 blade server and cloud computing solutions. Recent wins in the cloud include companies like Microsoft, Facebook, Amazon and Yahoo. In this business is poised to grow exponentially over the next

few years in terms of hardware, infrastructure and services.

As I mentioned, many of these solutions start with a client. Two weeks ago we launched our new latitude E series notebooks. The largest global commercial platform roll out in our history and we'll be following it up with the complete refresh of our commercial desktop and workstation portfolio.

So these are just a few examples of how we're designing solutions and secrete products to help simplify IT for our customers.

Growth in our enterprise portfolio demonstrates that customers are increasingly confident in our ability to design and support complete solutions and as a result, they're expressing interest in deeper relationships. That's translating into growth today and opportunity in the future. Not only do we see a big commercial opportunity in servers and storage, due to data center consolidation, virtualization, and cloud computing, but also strong growth in enterprise services and more mobile commercial customer base.

And all the activities that I've talked about are squarely focused on building broader and deeper relationships with commercial customers. Again, this business that has generated \$53 billion for us in the last year.

Beyond the commercial business, we continue to see tremendous opportunity as consumers transition to mobile computing, wireless broadband and smaller devices.

Now, let me turn it back over to Lynn.

Lynn Tyson:

Thank you very much. Kara, I think we're ready for Q&A please.

Operator:

Ladies and gentlemen, we will now begin the question and answer portion of today's call. If you have a question, please press star one on your telephone keypad. You'll 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.

Your first question comes from the line of Bill Shope with Credit Suisse.

Bill Shope:

Obviously, I have a question on the gross margins. Can you help us quantify what portion of the gross margin decline came from the deferrals you mentioned versus pricing?

Brian Gladden:

Yes, the Europe services deferral – again, its cash neutral to us and it was driven by the way we market and present our service offerings to customers in Europe, it forced us to defer more. It really was two to three cents per share impact in the quarter.

Bill Shope:

And how's that going to play out the rest of the year? Is this going to be a headwind the rest of the fiscal year as well?

Brian Gladden:

You know, as we continue to grow the services business, we will have some continued impact to that – not going to talk about how much, but it will continue to be a potential issue for us.

Bill Shope:

OK, thank you.

Operator:

Your next question comes from Katy Huberty with Morgan Stanley.

Katy Huberty:

Thanks and good afternoon. I want to follow up on margins. If not for the EMEA region segment profitability would have grown by half a point sequentially versus the 50 bit reported decline. So, can you help us better understand what went into the decision to invest so aggressively in EMEA and why those investments had to occur in July such that it was worth taking such a big hit on profits at the reported level?

Michael Dell:

Yes, I think it's a fair question. You know, I think whenever you're restarting growth, what I can tell you is that it's an imprecise process and we certainly see some parts of our business where we were probably a bit too aggressive and we're kind of modulating for that now.

Katy Huberty:

How quickly can you go back and fix that in the coming quarters?

Michael Dell:

We can fix it right away.

Katy Huberty:

OK, thanks.

Operator:

Your next question comes from Richard Gardner of CitiGroup.

Richard Gardner:

Michael, I just wanted to follow up on Katy's question and it sounds like you feel like you were overly aggressive in Europe, should we infer from your comments that you do intend to modulate back the growth in Europe in the coming quarter. and could you talk about whether what you did in Europe was a response to a significant weakening in demand in the region or was it that there were some large strategic customers, could you just provide any more detail on exactly why these particular opportunities were so strategic for you?

Michael Dell:

Well, it's a multidimensional equation. On the one hand, you have expectations of improvements in cost, and on the other hand, you have the sort of opportunity to grow, the addition of new products, and new countries, and new customer segments and then you have the competitive overlay. We've been expanding rapidly throughout EMEA and also, you know I think its fair to say that some of the western European economies you know have slowed a bit, you know creating some pressure in that environment. But when we look at it on balance, we believe that our margins can certainly improve quite a bit in Europe.

Richard Gardner:

Could you expand at all on the comments regarding the competitive overlaying Europe and what you're seeing there?

Michael Dell:

Well, its just one of the factors in the multidimensional equation. I wouldn't call it out as being a particularly more significant than in any other region.

Richard Gardner:

OK, you're not saying that there's been a significant increase in competitive pressure in Europe

though?

Michael Dell:

I mean, I think if I look at the – the situation in the second quarter, I think we'd have to say it was more self inflicted.

Richard Gardner:

OK. All right. Thank you.

Operator:

Your next question comes from the line of Ben Reitzes of Lehman Brothers.

Ben Reitzes:

Yes, good afternoon. Thank you. My questions center around cash. I believe if my math is correct, year over year – year to date, your cash is down about 24 percent. I know you talked about training four quarters, but cash flow if you do year to date may be running below, at least my expectations, I was wondering how big a snap back are you guys expecting in the back half and you know you bought back 1.4 billion does that mean you have to borrow anymore, or do you feel like you'll generate it all back in the back half and I have a follow up if I may.

Michael Dell:

Yes, Ben, you know I would say – again, we have 3.4 billion of cash flow in the last four quarters, I would expect some improvement in the second half of the year. You know, the cash conversion cycle dropped by about a day and a quarter, and most of the impact in the quarter was really linearity around sales. We had a relatively backend loaded second quarter in terms of shipments. So we hope to get some of that back. We are – we're kicking off internally a regular working capital council that will be focused on driving the key levers there for cash flow in the second half of the year and again, one of the things we're going to do as well is change the comp metrics for the company to include a cash based metric in 2010. So, cash is a big focus and we'll continue to work to improve it.

Ben Reitzes:

Do you still have the expectation that cash flow will equal EPS for the year?

Michael Dell:

Yes, you know I think – we think cash will be better than net income for the year.

Ben Reitzes:

OK. And then, Brian just – you've been on board now at least a few months and any progress on the DFS assessment and anything that you might want to talk about what you're looking at in that portfolio has close to 20 percent subprime receivables, I was wondering if there's just any comment on whether you know we could expect a write down there, given the environment.

Brian Gladden:

Yes, we don't expect any write down. We feel like we're adequately reserved. We're watching it closely. We are in the midst of the strategic assessment. As we've said, we'll be ready to talk about something there during the third quarter and that's still on track.

Ben Reitzes:

All right. Thank you very much, Brian.

Brian Gladden:

You got it Ben.

Operator:

Your next question comes from Tony Sacconaghi with Sanford Bernstein.

Tony Sacconaghi :

Yes, thank you and good afternoon. I'm sorry, I'd like to revisit the EMEA and gross margin questions, if I could.

On the EMEA side, the market data says EMEA PC units grew 24 percent in the quarter, that was the highest in the last five quarters. Dell's growth rate in revenue terms is actually the lowest in the last five quarters. That points to one or potentially some combination of two things. On the surface, it points to a fundamentally uncompetitive operating – a fundamentally uncompetitive offering from Dell or an increasingly uncompetitive offering from Dell given the market's getting stronger and your performance is getting weaker.

Alternatively, it points to a dramatic fall off in the month of July, because the Gartner data is calendar data? Can you comment on it, but this notion that you -- I mean you comment as though you were aggressively pricing and you know, you tactfully did that to accelerate your growth rate, but in fact the opposite happened.

Michael Dell:

Yes, Tony there's one possible scenario that you left out and that is that Dell has a high share of the commercial space in Europe, but a very low share of consumer. And that's exactly what you'll find was the anomaly. In fact, we gained share in the commercial segment in Europe and we are almost infinitesimally small in consumer in Europe.

Tony Sacconaghi :

But Michael, wouldn't that have been the case for the last four quarters as well where you were growing at a much higher rate, that is essentially all of your business, so you clearly were doing better relative to the market in the rest of Europe for the last four quarters as well. I'm not so sure why that would have been different this quarter than the last four.

Michael Dell:

Well, if you're talking relative to the industry, I mean our commercial units were up 20 percent, which you know, all the data from IBC would suggest that that's faster than the industry growth in commercial. The biggest different relative to the industry is that we have a really, really small consumer business. Consumers growing quite fast in Europe and we're not participating in it. And we chose to prioritize Asia and the United States.

Tony Sacconaghi :

Again, not to go tit for tat, but my sense is given your overall revenue growth didn't accelerate and you're essentially saying its all commercial and you're European growth rate was the lowest in five quarters, yes, that still is pretty good relative to the industry, per se. But it's still not as strong as it was over the last four or five quarters, despite the fact that you seemingly were really stepping on the gas in terms of – in terms of pricing here. And I'm wondering if that points to something.

Michael Dell:

And we gained share in the commercial segment.

Tony Sacconaghi :

OK.

Lynn Tyson:

Sorry, I have to go to the next question. Thanks.

Operator:

Your next question comes from Brian Alexander of Raymond James.

Brian Alexander:

I just – I guess to follow up and perhaps belabor this point. The comment that you priced aggressively ahead of cost improvements, I assume the cost improvements that you're referring to relate to product design. So, were you late with the product launch and you had to shift based on previously agreed upon pricing and in terms of the margins improving in Europe going forward, does that happen because you're going to start to realize more significant cost declines or that you're just not going to price as aggressively as you did this quarter?

Michael Dell:

We didn't really have any late products. I think the going forward answer is really a combination of you know better pricing execution and we believe improving cost footprints on new products, and if you've been reading the news in the last few days, you know we're deep into product introduction season. We're introducing you know a large, large number of new products you know last week, this week, and you'll see that continue.

Brian Alexander:

I guess I'm not sure, why aren't the cost improvements more lock step with the revenue performance. And why are we seeing a lag between the aggressive pricing, I guess and the cost improvements. And are – going forward, are they going to continue to be mismatched so that we're going to see more volatility in the model?

Michael Dell:

Well, our goal is certainly not to mismatch them. And I think I kind of pointed earlier that we didn't match them as well as we would have liked to in Europe.

Brian Alexander:

OK, thanks.

Operator:

Your next question comes from Keith Bachmann of Bank of Montreal.

Keith Bachmann:

On the same themes, I wanted to talk about the consumer side of the business. I was hoping, first of all, if you could just clarify, when you talk about cost improvements, you've mentioned Europe quite a few times, was that part of the retail business profit challenges.

And then, related, you had a fairly healthy step up in the global consumer, both on a year over year basis, well certainty on a year over year basis and yet it stepped back in to a loss mode. So why wasn't there, based on volume variance or revenue variance in the consumer business, why was there no improvement there in terms of the profitability. And I have a quick follow up, please.

Brian Gladden:

Yes, it's Brian. You know, we grew at two times the industry. We increased our share in consumer to 9.1 percent and again, we're making investments in strategic pricing decisions to get into markets ahead of some of the costs that we see coming. We launched seven new products in consumer in the first half of the year. By the end of the year we'll have launched 24 new products. So there's a load of new product introductions coming in the second half of the year that are going to give us a better cost position and improve our competitiveness there. We would say that the opinc – with the litigation expense, generally about flat with where it was. So we continue to invest in that business by getting into share position.

Keith Bachmann:

Brian, I know you've only been there a short period of time, but it sounds eerily reminiscent of some of the comments HP used to make in a previous administration. You're talking about share gains, but there's no profit to show for it. So can you just confirm that some kind of profit metrics that you anticipate to consumer business moving into a period of profitability. Because otherwise, if we just have quarter after quarter of share gains without profit its meaningless.

Brian Gladden:

Now look, we're in the consumer and the retail business to make money and generate cash flow. And if we didn't see a path to do that we wouldn't be in the business.

Keith Bachmann:

Could ...

Brian Gladden:

Totally right.

Keith Bachmann:

Will you show consumer profitability in the second half of the year?

Brian Gladden:

I think you'll see over the next four quarters improving profitability.

Keith Bachmann:

Great. Thank you.

Operator:

Your next question comes from Maynard Um.

Maynard Um:

Focus on your OpEx loan here. You've done a good job in the quarter, but if you look, you launched a number of new desktops, notebooks, server products all in this current quarter. Is it safe to assume that we should expect more investments into the sales and marketing around these new products into this quarter and the next?

And then, just relate it to that. As you ramp those new products, which you say are better on the cost structure, will that help to offset the deferrals and the other issues and help to stabilize the gross margins over the next, lets say, couple quarters? Thanks.

Brian Gladden:

Yes, on the second part, definitely.

In terms of OpEx, you know we are making strategic investments and adding resources on the commercial side of the business, on product development, as we've taken out G&A and other OpEx costs in the business. So realigning the cost structure and focusing it more on the new products and commercial capability in the field is clearly a big part of what we're doing.

Maynard Um:

You think those will offset each other, or from an absolute dollar perspective, should we expect an increase because it's a pretty large product launch that you've done?

Brian Gladden:

Well, I think with the magnitude of growth that we're seeing, I think you'll see OpEx dollars ultimately growing and scaling with the business once we get it to the right level.

Maynard Um:

Great. Thanks.

Operator:

Your next question is from David Bailey of Goldman Sachs.

David Bailey:

Thank you very much. Your comments about pricing more aggressive than was necessary sounds very familiar to what happened a year and a half or so ago. What management systems are you putting in place to prevent this going forward?

And then, related to that, given the need for strategic investments to drive your longer term growth, how much of the \$3 billion in cost savings do you actually expect to hit the bottom line when you get there?

Male:

You know, we are actively managing the decisions around where we're going to grow and where we're going to invest in strategic pricing and we look at that really every week as a leadership team. So, you know sometimes it's difficult to judge whether you're pushing it too far. I think that's really the only answer.

David Bailey:

And what about the three billion, how much of that do you expect to actually hit the bottom line?

Male:

Well, I mean – again, we're actively managing the process. We have clear line of site to deliver the three billion. We're making trade offs you know really on a regular basis as to where the most effective place to put those dollars are. We're not going to talk about specifically where it goes, but you know it's got to drive improved profitability in the business ultimately by supporting growth and allowing us to be competitive in the marketplace if we don't drop it through.

Male:

I mean either it drops to the bottom line or it goes into investment that we believe drops to the bottom line later in the form of more dollars.

Male:

Better returns.

David Bailey:

OK, thank you.

Operator:

Your next question comes from Chris Whitmore of Deutsche Bank.

Chris Whitmore:

Following up on the three billion, Brian, you mentioned you have a series of tracking tools that allows you to track progress of attaining that three billion and how it flows through the model. Can you give us a sense as to where you are regarding that three billion as a percentage of completion basis?

Brian Gladden:

Well, I would break it into two pieces in terms of identifying and working on projects. You know, we've got it fully in our site. So you know, actually frankly more than three billion is sort of targeted to give ourselves some cushion there.

In terms of actually realizing it and bringing it through and finding ways to redeploy that benefit, you know its early in the process, and again and much of it is tied to the product launches that we have coming. So ...

Michael Dell:

Yes, its very – its very levered to new product introductions where we've made a much better, you know feature value trade off as Brian mentioned earlier. And you know we believe that derives, you know a significant portion of this.

Chris Whitmore:

Perhaps a follow up, can you give us a sense as to the percentage of total units using the new model currently and any targets you have you know towards year end in terms of percentage of units using the new manufacturing model. That'd be great.

Male:

Well, I mean in terms of new products that have been cost optimized, it's a significant minority of our current – current portfolio and shipped product. So, we've got a lot more to do there.

Chris Whitmore:

Do you have a target for year end?

Male:

In terms of how much – what percentage?

Chris Whitmore:

Yes.

Male:

No. I can't say that we do. But we have that clearly laid out product by product as the launches, I just don't have the math in terms of what percentage it is. But you know, virtually ever new product introduction that you see will have you know some – to some extent gone through this process and over time that kind of goes to 100 percent.

Chris Whitmore:

Maybe the easier question here is when do you expect these manufacturing driven cost savings to start to improve the gross margin and actually start to show up in the financial results?

Male:

Again, I mean – again, the thee billion commitment was really between now and 2011 and I think we continue to work through that and we – you'll see more in the second half of this year than you saw in the first half. It's accelerating and the momentum is good.

Chris Whitmore:

Thank you.

Operator:

Your next question comes from Louis Miscioscia with Cowen.

Louis Miscioscia:

Michael, you said that the European situation from a margin perspective can get fixed right away and I think if we look back to fiscal '07, you actually had a quarter where European profitability dropped off very dramatically and then bounced back rather quickly, it bounced back I believe,

\$150 million quarter to quarter. Do you think that that is possible here?

Michael Dell:

Well, you know the – it would be clear, I'm referring to pricing changes you know and you know kind of let's say overly aggressive pricing. I think that's something that we can fix rather rapidly.

As far as what's the improvement going to be quarter to quarter? Not going to get – not going to give you a forecast.

Louis Miscioscia:

OK, one other quick follow up question on your comment about demand out there. you know has there obviously been a couple of quarters where you've been talking about a weak tech demand environment and your printed numbers actually look OK, so would you be able to make a predication as to whether your comments are obviously going to you know hurt either revenue or pricing or is it just trying to set the stage and you would expect obviously revenue and at least margins in other areas, besides Europe, to obviously be holding up?

Male:

Well, you know our belief is that you know we've been growing faster than the industry for a couple of quarters now, we believe that will continue. Of course the bigger question is what's the industry growth going to be? A lot of moving parts there and we don't quite frankly know. We have a good sense for what our demand picture is and you know all of the indications we have tell us with the products we have and the you know, efforts we're putting forth, we'll continue to grow faster than the industry.

Louis Miscioscia:

OK, thank you.

Operator:

Your next question comes from Jayson Noland from Robert Baird.

Jayson Noland:

Thank you. Just to change gears here a little bit. Could you give us a general update on progress with resellers and then maybe specifically talk a little bit about EDS, if you can give us a feel for the percent of business you do with EDS and if that's at risk now.

Male:

Partner business is running at about a \$12 billion annual run rate. We've got about 23,000 partners in the Americas and about 43,000 globally. We've got partner direct – the partner program you know running basically all across the world now and you know it's a – it's a compelling program, you know it's easy for these partners to sign up. They take advantage of our build to order capabilities. They're taking advantage of our services. We're seeing a healthy mix of products with these customers. They tend to you know sell our enterprise products and so, you know that's going pretty well.

EDS is a small you know portion of our business. It's not material on an annual basis and we certainly believe that there are a number of EDS competitors where we're strengthening our relationship. We've already seen some of that. And also, the customers where Dell, EDS have engaged in the past, you know its our belief that in many of those cases the customer is quite committed to Dell product architecture and you know we don't see – we don't see those accounts as all flipping over, if you will.

Jayson Noland:

Thank you.

Operator:

Your next question comes from Jeff Fidacaro with Merrill Lynch.

Jeff Fidacaro:

Hi, good afternoon. Wondering if I could just touch back on the OpEx side. When you look at your customer facing employee growth, I believe you talked about it going from 54 percent to about 62 percent of the mix and yet the – what's left on the headcount reduction target is – the 1,500 this quarter and you're going to reach 8,900 next quarter, where do we stand here as far as expansion into new markets and where do you have to sort of increase that headcount as far as resources on the customer facing side, or is there more headcount reduction to come post the 8,900 person target?

Male:

Well, you know I would say, during the course of the headcount reductions we've done over the last you know six quarters, we've been adding resources in terms of the customer facing capability in emerging countries and in new product lines supporting our enterprise growth, supporting the services business. So we've been making that trade off and reducing the you know the customer facing – or improving our customer facing mix during that period of time.

We'll continue to look at the scaling and our mix of resources going forward. There will be a continued focus of adding front line growth oriented resources while we continue to look at our G&A structure.

Jeff Fidacaro:

Great thank you.

Operator:

Your next question comes from Bill Fearnley with FTN Midwest.

Bill Fearnley:

If I could to the gross margins. Any effect on gross margins here from less – less of an upselling opportunity as you move to a more direct and indirect model and as you move towards more fixed and standardized skus and share some of the up sell opportunity with the channel. Does that have any effect here on margins either this quarter on the near term, as you share the up sell opportunity with partners?

Male:

Well on the VAR channel, you know we've actually seen pretty good partnership on services and they tend to take a richer mix of products with enterprise products. So, on an operating income basis, that's a that's a healthy business for us. On retail, that's a different story and really lots going on the product side to engineer products that allow us to improve the overall you know portfolio profitability of consumer.

Bill Fearnley:

And quick follow up if I could. When you look at the direct and indirect mix, you keep talking about investments worldwide and improving momentum there. How should we be thinking about the indirect, direct sales mix here from a channel perspective? Should we see any dramatic changes here in the next – you know in the next year, year in a half year? Or do you just see the channel becoming a gradual part of your business or do you see big moves in the percentage of business going through the channel overall. Thanks.

Male:

You know if its op income neutral and we can expand our footprint rapidly, then we're sort of indifferent on the commercial side. And so we're watching that very carefully to make sure that P&L stays healthy. But we're seeing pretty good acceptance from these VAR partners and its growing nicely for us.

Bill Fearnley:

Thanks.

Operator:

Your next question comes from Clay Sumner with FBR.

Clay Sumner:

Thanks. I want to return to the gross margin and look at it from a sequential basis from the April quarter. Overall revenue was higher sequentially. Revenue was higher in every category, except for notebooks, where it was essentially flat. ASPs sequentially appear to have been flat to up for both desktops and notebooks and global consumer business, sequentially, was actually down in the mix from 18.3 to 16.9. So, we're still trying to understand – it was the pricing – the aggressive pricing you're talking about, was that restricted to services pricing in EMEA? Is that the issue?

Male:

No, the pricing impact in Europe was really – because a lot of it, frankly, was in the notebook business and on the client side of the business. That's the major driver, obviously other than this increase in EMEA service revenue deferral. Those would be the two major drivers.

Clay Sumner:

So sequentially speaking, were notebook ASBs down?

Male:

Yes. Yes, sequentially notebook ASBs were down. I'm not sure where you got the fact that they weren't.

Clay Sumner:

OK. Thanks. I'll go back and look at that.

Male:

Yes.

Operator:

Your next question comes from Mark Moskowitz with JP Morgan.

Mark Moskowitz:

Yes, good afternoon. A question on inventories. You've had a prolonged upswing as I presume the inventory uplift has been related to your indirect channel build and this quarter you did have a down tick. Can you talk about what happened there? Are you losing momentum in the indirect channel build or a better management style?

Male:

No, the indirect channel build is a small piece of the inventory balance. The major driver quarter on quarter in inventory reduction was a specific decision to reduce our strategic buy and where it made more sense for us to do that.

Mark Moskowitz:

And lastly, on storage, can you talk a little bit more about the storage business in terms of the puts and takes behind the growth. Are you expecting sort of reacceleration as the midrange product line was refreshed earlier this summer.

Male:

Yes, storage had a great quarter. there was some portfolio balancing towards the higher margin products, you know, power ball was up quite strongly with the power ball disc growing you know very, very strongly. Equilogic grew year over year, more than 150 percent. And you know operating income levels of storage were at kind of record levels. So we're seeing you know strong growth in that business and investing heavily in it.

Mark Moskowitz:

Thank you.

Operator:

We'll now take our final question from Shannon Cross of Cross Research.

Shannon Cross:

Thank you. Got in under the wire. Question for you on R&D levels. You've obviously had several new products that you've launched. I'm just kind of curious as we've seen it tick up, what we should think about in terms of R&D on a going forward basis. And then I'll just throw this follow up question in before you cut me off, because I know you guys want to be done here.

The compensation, you'd mentioned, changed to cash, Brian, if you could just give us a little more color on that. Thanks.

Brian Gladden:

Yes, in terms of R&D, I mean again, we continue to try and optimize the OpEx for the company and clearly that's one of the places we want to be able to invest to support the growth of the portfolio to support the product development activities around cost out. So those are – in the context of OpEx that's what we'll try and do is be able to fund that by cutting in other places.

What was the second question?

Shannon Cross:

The second question was just on – you'd mentioned something during the cash flow commentary about compensation change to cash by 2010, I may have missed exactly what you said there but I didn't know if there was some change in compensation or something we should be thinking about from a cash flow standpoint.

Brian Gladden:

Yes, one of the things we're working with the board on is implementing a portion of the executive compensation and bonus plans for the company to be tied to our cash flow performance.

Shannon Cross:

Got it.

Michael Dell:

We actually announced that at our shareholders meeting.

Shannon Cross:

Right, right. OK, I just – I misunderstood. OK.

Male:

OK?

Shannon Cross:

Thanks.

Male:

OK, so want to leave you with a few thoughts, you know we are focused on executing our strategy and improving our competitiveness. With our sights firmly set on improving

profitability over time.

We have reignited growth in this business and expect more to come in the second half of the year. We're expanding our solutions portfolio tailored at customer needs and we expect this trend to continue and we will continue to deliver business and financial results that deliver intrinsic value back to our shareholders.

Thank you very much and we look forward to seeing you again soon.

Operator:

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

END