



Michael Dell Remarks
Keizai Doyukai (Japan Association of Corporate Executives)

Tokyo -- May 25, 2004

MR. FUJISAWA: Ladies and gentlemen, thank you for taking the time to attend this meeting. For our first global forum, we are honored to welcome Mr. Michael Dell, the Chairman of the Board and Chief Executive Officer of Dell, Inc. As you know, Dell bases its business on selling custom-made PCs directly to customers, bypassing any intermediaries in the distribution system. Dell has been hugely successful with this innovative business model.

Following Mr. Dell's presentation, Dr. Iwao Nakatani, the director of Research for the UFJ Research Institute and president of Tama University, will join us to act as a moderator for the question and answer portion of the session.

I would like to invite Mr. Michael Dell on stage now to share his thoughts with you on Dell's business.

MICHAEL DELL: Thank you, Mr. Fujisawa. Good morning, everyone. Thank you for joining us today. I look forward to a good discussion today and am happy to be here to describe what's been going on in our company and hear your thoughts as well.

I want to begin by sharing a bit about our business results as a company. We finished our first quarter with strong results. We had cash flow of about \$1 billion with almost \$12 billion in cash and investments, so we're not a company that has debt.

We used \$1.1 billion to repurchase 34 million shares. It might interest you to know that in the past four to five years, the number of shares outstanding has been reduced by almost 20 percent because of the share repurchase program.

Our business is growing. We grew 38 percent in Asia, 37 percent in Europe and 25 percent overall for the company. Our revenues were \$11.54 billion, which was a company record. This year our company revenue should be close to \$50 billion, which is an improvement from last year's results of \$41.4 billion.

We also achieved strong profitability with operating income of \$966 million. Our earnings per share grew 22 percent over the prior year and our operating expense ratio is 9.6 percent, which is approximately one-half the rate of our competitors.

(Speaking to slide) This kind of triangle symbolizes the balance at Dell between liquidity or cash flow, profitability and growth. We think it's very important to keep those three key financial measurements in balance at all times.

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Japan has been a major focus market for Dell. During the last quarter, our unit shipments grew by 24 percent, which is four times faster than the market. We became the No. 3 overall provider with 11 percent market share, and also took the No.1 position in x86-based servers, which represent about 90 percent of all servers that are sold. This was a major achievement for the company.

We've been the fastest growing company among the top five companies in the Japanese marketplace, and we're proud of the reputation we have for service. We recently won, for the fourth year in a row, a key customer satisfaction survey here in Japan, which recognizes our teams for the support we provide to customers.

One of the interesting aspects of our business is the fact that we have been able to take the Dell business model and apply it all over the world. Our company is now 20 years old. This chart tracks the market share that we have achieved in various countries based on the number of years that we have been in those markets. What you can see is that almost all countries' market shares have exceeded the U.S. based on the number of years we've been in the market. This tells us that our concept is one that has global appeal, not based on any single culture, and is an economic principle based on value.

Take China as an example. We've only been in China now for five years, but it is one of the fastest growing markets, surpassing the level of almost all countries that we've been in.

We now have the No. 1 market share position in several markets including the U.S., the UK and Canada. But, what I think this chart indicates, is that we are well on our way to the same kind of position in many markets around the world.

These countries represent about two-thirds of the world's market. If you look at the top 13 markets in the world, we grew our market share in all 13 of those markets. We've really been able to apply the Dell direct model all over the world. This business model, for those of you who are not necessarily familiar with it, is based on five key tenets that we've used in our business and that have been very valuable for us.

We focus on having the most efficient path to the customer, whether it's face-to-face with large customers, over the telephone or through the Internet.

Single point of accountability is also important. If a customer has a problem, we want them to contact us, not to go through a dealer or distributor. We want to be responsible for that.

We build our products to order. Last quarter, we had four days of inventory – which means our inventories turn about 100 times per year, a little faster than most industrial manufacturing companies. That's partly a function of the information that we have from our customers, but also because we're building products to order, and we don't have any finished goods inventory either waiting in our warehouses or in channels.



Cost leadership has been essential for us, as this is a high-volume business. We focus on how we can deliver the best value to our customers and pass the savings along.

And, we also rely on standards-based technology. As technologies move into high-volume and into the mainstream market, there's a fairly predictable process of standards taking hold. Dell can help catalyze this and create those standards – and also bring them to customers very quickly and efficiently.

All of this results in substantial benefits to users, which is why we've been growing. Customers have been attracted to us because we provide the best value and highest quality based on the most relevant technology. Building systems to order allows us to provide products that have the unique requirements users want.

Contrasted with other systems, which are trying to predict or anticipate what the customer wants, a build-to-order system is quite flexible. Tailoring service and support and customizing that to the requirements of the user make our products easy to buy and easy to use. Each of the tenets of our model has a strong foundation based on what customers need.

Looking at standardization, this has been a key driver of our growth. If you think about the different technologies that are coming and available in our industry, there is a pretty rapid trend. For example, as new semiconductor technologies or new network topologies come out, these things become essentially high-volume products. And we have advocated this kind of high-volume, low-cost model, as opposed to a high-cost, low-volume model.

Let's take storage area networks as an example. Most people do not know what a storage area network is, but most everyone has one – it's where large companies store databases and key customer information. We've been able to take this critical technology and drive the cost down quite dramatically, by about 70 percent over the last two years. This has become almost a \$2 billion business for us in our enterprise sector. Last year, Dell servers, storage and services represented about \$9 billion in revenue.

Our own R&D plays a role here, but we also leverage the technology ingredients of our partners. We bring the best technology available from the industry to our customers in the most efficient way possible.

Let me give you a few examples of how this has affected the marketplace. Go back to about 10 years ago when a supercomputer from Cray cost about \$2.2 million. It had 512 megabytes of memory and performance of 4.2 gigaflops. Now you don't need to know what gigaflops are, but it's like horsepower – although gigaflops measure the speed of the computing engine.

Well, today we sell a group of servers attached together, called a "cluster," with 16 gigabytes of memory and performance of 97 gigaflops. That's about 20 times the performance and 32 times the memory for only \$70,000.

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Let's say that you wanted to decode the human genome; produce a full-featured movie using digital animation; or develop a new pharmaceutical technique to simulate different medical scenarios. Now this kind of computing power is very affordable.

Recently, the National Supercomputing Association, a center in the U.S. operated at the University of Illinois, installed a new supercomputer with about 3,400 microprocessors. It's the fourth most powerful supercomputer in the world and it's all based on Dell servers. They were able to do that for about one-tenth the price of a traditional supercomputer.

Let's also look at high-performance workstations, the kind that design jet engines and airplanes or analyze fluid dynamics. About 10 years ago, the most popular computer used for these tasks were from Sun and had a 50 megahertz processor and 64 megabytes of RAM for about \$28,000. Today, a Dell Precision 360 workstation is a little less than one-tenth that cost and significantly faster. In fact, more than half of all the jet engines in the world are designed using Dell Precision workstations. We see very complex applications, which previously weren't possible on these kinds of platforms, now being done on highly-affordable, commoditized technology which results in significant savings for the customer.

We've also seen proprietary profit pools collapse in other market such as servers and storage. On this chart, you can see an example of this where from 1997 to 2003, the profitability of the overall industry came down substantially. Now over 90 percent of the servers installed in the world are based on the industry-standard Intel architecture running either Windows or Linux.

The standards-based model really makes a big difference in the cost. We've been able to partner with companies like SAP, Oracle and Microsoft, using operating systems like Windows and Linux, to really drive the affordability of enterprise systems.

About two years ago, we said that this would be about an \$800 billion market for Dell by 2006 – a market that spans PCs, servers, storage, networking, software and peripherals and services. At that time, our market share in the PC sector was about 13 percent. It's now up to about 18 percent, still just 5 or 6 percent of the total \$800 billion opportunity.

We see a very substantial and growing market for us and an opportunity to use our business model across this entire sector to one day become a much larger company. We've already talked about a goal of reaching \$60 billion in revenue; we think this year will be close to \$50 billion, so we're actually ahead of the ambitious plan that we laid out a few years ago.

As you can see on this final slide, we just celebrated our 20th year as a company. We thought it would be interesting to compare our first 20 years to that of a few pretty well-known companies, such as Microsoft, Wal-Mart and GE. They didn't have telecommunications and the Internet back in 1888 when IBM was formed.



This suggests that there's something going on here that is quite valuable for customers. We're certainly looking forward to the next 20 years and hopefully we can keep our track record going of growth and success.

I know many of you are customers of ours, so I want to thank you for your attention and your trust. I'll come and join you here at the table and look forward to your questions.

Thank you.

MR. NAKATANI (MODERATOR): Thank you very much. I'd like to start with a few questions and then open it up to the audience.

You mentioned your company's \$60 billion goal. Now, for the past 10 years, Dell's share price has grown by more than a thousand-fold. Is this true?

MICHAEL DELL: Yes. Actually if you go back to 1990, our share price has increased about 50,000 percent. So, if you had invested in Dell when we launched in Japan in December of 1992, I think the return would be about 30,000 percent. A pretty good investment.

MR. NAKATANI: So if you had invested in Dell, I'm sure everyone would be billionaires by now. I'd like to go back to the direct model – a model that everyone is familiar with and many have probably tried to copy. Do you feel that there is something about the model that cannot be copied by others, or if you have confidence in a certain area, could you tell us what that is?

MICHAEL DELL: I think if you look at our business system, it's fairly easy to understand what we're doing. It might not be as apparent at first and you'll need to dig a little deeper to understand the complete thing. I really think the harder parts to copy involve culture.

MR. NAKATANI: Culture?

MICHAEL DELL: Culture. And execution. If you go back to 1992, almost all of our competitors announced that they were going to set up a direct business model. At that time, we had about \$1 billion in revenue. Well, this year, we'll have \$50 billion in revenue, and they haven't had so much success in copying the direct business model.

I think there are a few other things that come into play. It seems to be quite challenging to operate both an indirect and a direct business model at the same time – the transition from one to another is something that no one has really done.

I also think many companies find themselves in a situation where they have a channel-based strategy for products that they also want to sell direct. That's very hard to do, because the dealer often wants to know what is going on in the business, and the company may rely heavily on the dealer in other areas,

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such as services. Companies that are good at developing or manufacturing products may not have a strong understanding of customer relationships, and that's very difficult to develop.

MR. NAKATANI: You also mentioned culture as the key to success. You're at the very center of the Dell culture. What if, in the future, someone takes over for you? Do you believe that the Dell culture can be passed on and continued?

MICHAEL DELL: We've studied that quite a bit and it's essential that our culture continues. Hamada-san is running Dell in Northern Asia. He knows how to take the Dell culture and apply it here in Asia – he's been very successful. We have Paul Bell in Europe doing the same thing there.

We have been able to transfer our culture to our employees around the world, and I think we've articulated it clearly for them. Inside the company, we have something we call "The Soul of Dell," which is an aspirational document that talks about what we want to become as a company. And, we measure the success of our leaders in both what they accomplish and how they accomplish it. We have a survey called "Tell Dell," where we ask our people how they're enjoying working at Dell and what they value in their careers so that we can build the kind of culture that is meaningful to them.

MR. NAKATANI: So, as CEO of Dell, you have to sacrifice a lot of time to train and nurture so many people. What percentage of your time is spent on this type of culture-building activity?

MICHAEL DELL: We probably spend about 20 percent of our time just on leadership and organizational development, but it also flows into just about every activity. For example, if we have an operations review inside the company, we'll also have a discussion about the skills our leaders need to be ready for the next level of growth and development. Seven years ago, we had \$7 billion in revenue; this last year it was \$41 billion; in a few years from now, it could be \$70 billion. This means we have a huge challenge in terms of growing and developing leaders within the company, so we spend a lot of time talking about that and thinking about how we can prepare the next generation for the challenges ahead.

And, when we enter new businesses like printing or the storage, or enter new countries, we need leaders who we have grown inside the company and who are ready to take on those challenges.

MR. NAKATANI: You seem to have very good communication with your staff. Do you visit the leaders in the different regions frequently or do you ask them to come to the United States? What is your approach?

MICHAEL DELL: Kevin Rollins and I run the company together, and he will become the CEO in July. We both visit different regions several times a year – he's in Europe this week; I'm in Asia right now. I'll be in Asia and Europe three times each this year and will also spend time in South America, Canada and in our different U.S. locations. Kevin's schedule is similar, but we're usually in different locations at



different times. We're meeting with our teams, we're meeting with customers, and we're out explaining what our business is all about.

We do have a quarterly meeting that lasts about one week, usually at our headquarters, where we bring leaders from the regions in to talk about the business. However, there's no substitute for going out and seeing the business firsthand, going where the customers are, seeing the factories, having town hall meetings with employees, and getting a sense of what's really happening.

We also have tremendous access to real-time information. Because we are working directly with customers, we're not disconnected from what's really going on in terms of sales. We don't ship things off to a distributor and then wonder what really got sold or what didn't get sold. I can get a report every morning that tells us exactly what we sold the prior day, to what customer, in what region, at what margin, and how that compares to sales in previous quarters. This allows us to adapt our business very quickly so that we're focusing on the right areas.

MR. NAKATANI: Thank you. Earlier, you projected a slide that showed 20 years of growth in other countries. We all know what happened to the IT industry several years ago. However, if we look at this curve, it seems that the downturn trend had no effect. What is the reality?

MICHAEL DELL: The reality is that we grew strongly even while the industry was in a downturn. Take the UK as an example. This past quarter, we grew 39 percent and our No. 2 competitor declined by 12 percent. That's a spread of 51 points.

I think it comes back to the combination of economics, value, cost structure, the business model, service execution and logistics. There's not one magic thing, but there is a core business model that is just profoundly more efficient than competing models.

In the last three years, our computing business has earned about \$7.5 billion. If you look at our global competitors, they have lost \$12.5 billion – and \$10 billion of that is what's called the non-reoccurring charges. Although curiously enough, these charges just seem to keep reoccurring.

MR. NAKATANI: If I may change the subject, you recently have gone into the liquid crystal displays (LCD) business. Are you successful in this area as well?

MICHAEL DELL: Absolutely. We have No. 1 market share in LCD monitors and our business is more than twice the size of the No. 2 company. The reason is that we sell more computers than anyone, and typically, if you sell the computer, you sell the display. We also have a projector business, like these kinds of projectors here, although ours is smaller, quieter and more beautiful than that one.

Now the display business has many different facets. There are standalone displays, projectors and multifunction displays, which can also receive a signal from a DVD player. We captured about five percent of the market for multifunction LCD displays in the United States after just two quarters in the



market, so it's off to a very good start. In the U.S., we have more than 30 percent share in LCD displays.

MR. NAKATANI: Do you think you can use the same direct model for home appliances? In more modularized PC industry, the Dell model worked very well. However, when it comes to the information appliance business, is the direct model and build-to-order business really applicable?

MICHAEL DELL: What we find is that the supply chain and the logistics system for the delivery of many of these devices is still quite inefficient. If you think about the displays business, you have people who manufacture the glass itself and people who package the glass. You have distributors, you have dealers, and you have actual customers. As we analyze all the different costs in that chain, we find plenty of inefficiencies.

Part of this is leveraging the scale that we have in the displays business. It's also true that most of the customers that come to Dell are computer-centric. One of the great applications for these high-resolution, high-definition displays are computer signals, so therefore it's a very important field for us to participate in.

It would be incorrect to say we're going strictly after the television business. We're really going after the multifunction display business, which is much more than just the television.

And, increasingly, we're seeing young people use their PC and television as the same device. The signals are digital; they're putting them in the same room and they're using them together.

MR. NAKATANI: Many of the Japanese companies who are trying to globalize their business tell me that it's very challenging to reach customers around the world. Since you've been successful at this, what is the most important thing to share with our business leaders?

MICHAEL DELL: I think it comes down to talent – having a set of leaders who are capable, understand the business system, and are not trying to adopt a different way or model. Our business model is not an American system or a Texan system; it's a Dell model. And, it's a model that has been very successful in Asia.

We're at the stage here in Japan and China where we have national leaders who grew up inside Dell and have been part of the company from its founding here in Asia. They understand the business and how to use the model efficiently in their countries.

We do find that the best ideas come from everywhere in the world. For example, Hamada-san is participating in global councils where we share best practices for acquiring new customers, serving customers with a high standard, and for penetrating new market segments. Our leaders share ideas and apply them around the world.



MR. NAKATANI: At this point, I'd like to take questions from our audience.

QUESTION: Can you give us an example of one of your competitors who worked very hard and came up with a convincing business model? Maybe it was through copying your model or coming up with one that was totally different?

MICHAEL DELL: That's a good question. I don't think our competitors were doing nothing, but maybe the things they were doing were not working very well.

If you look at our global and local competitors, almost all of them have been breaking even, losing a little money, or sometimes making a bit of money. It was very rare if they could cover their cost of capital when they made a profit. And, as I mentioned earlier, the cumulative total from our competitors represents a fairly significant loss.

Now, there are examples. Apple clearly has a niche where they're profitable. You see Legend in China, which is profitable, although that has deteriorated fairly rapidly in the last two quarters, while we grew 60 percent last year in China.

If you go back to what drives customers to buy from one company or another – service, product quality, value – our cost structure is less than one-half of most of our competitors. So, if our gross margins are about 18 percent and our operating expenses are 9.6 percent, we can have about eight points operating income. If our competitors' operating expense is 20 percent, it's really not possible to earn a profit at that kind of expense ratio.

There's also a negative cycle that many companies find themselves in, where their revenues are declining faster than their costs. This means their expense ratio is going up and they'll have an even harder time recovering. In the U.S., we're No. 1 and bigger than the top five competitors combined – while being the only company that is profitable. I think it comes back to our business model.

But, if you go back five or ten years ago, we were smaller but the story was very much the same in terms of the cost structure advantage.

QUESTION: You talked about how Dell went from PCs to storage to servers and then display monitors. It seems like a natural progression to dominate the living room where Microsoft has the Xbox or Sony has the PlayStation. Do you plan on going that direction?

MICHAEL DELL: Well, in the \$800 billion market that we focus on, the consumer business represents only about 18 percent of the revenues. You wouldn't know that if you read the newspaper – you'd think it was 50 percent. So, the biggest opportunity by far is actually in the business market.

One of our more recent focus areas is printing because it's a large market that is adjacent to computing. We launched in the printer market in the U.S. about four quarters ago. We already achieved



17.5 percent market share in the all-in-one inkjet market. This year, our printing and supplies revenues will be over \$1 billion.

QUESTION: What is it that keeps you up at night with worry? What are your biggest challenges or biggest barriers?

MICHAEL DELL: The one area that concerns us the most is our own organization. How do we grow talent to keep pace with business growth? Hamada-san and I were talking about this in the car this morning for about an hour. We need leaders to grow all these new businesses that we're going into. And they really have to come from within the company, so we have to grow our own talent inside the organization. That's the biggest challenge that we have by far.

We also worry about the supply chain. We represent somewhere between 20 and 30 percent of the consumption of any given commodity of electronics in the world. For example, the level of investment in new semiconductor equipment and fabs has been quite low in the last four years, with the exception of one company who also makes microprocessors. Almost all the other companies did not invest very much during the downturn, and as a result, we're starting to see shortages of components, which certainly affects the industry's ability to grow. There's just not enough raw factory capacity.

We're spending a lot of time making sure we have the right relationships with these partners and if need-be, how do we catalyze the investments to make sure that when they build a new plant, we get the output we need to support our customer requirements.

QUESTION: I have two questions. China has many low-cost competitors, and I'm wondering if there lessons that you have learned from being in the market?

Second, you mentioned that Dell has almost \$12 billion in cash. Do you foresee new uses of that cash, and in particular, are mergers and acquisitions important to your continued growth?

MICHAEL DELL: China has been quite an interesting market for us. We sell products there; we support our products; we have a manufacturing plant in Xiamen which supports Northern Asia. We also have a design center in Shanghai where we design products for global consumption. And, of course, we have many suppliers. China is Dell's No. 1 provider of raw materials. Interestingly enough, Malaysia is No. 2.

But our cost structure is now basically equivalent to Legend's in China, and that was one of the first objectives for us in going into a market like that. If you went to Dell China, you would see something that looks very similar to any other scale operation in Dell in terms – this includes a direct sales force in major cities calling on large customers, as well as telephone- and Internet-based sales. China is our fourth largest market. It will probably be our third largest market within a couple of years and it's growing very well.



In terms of cash, we really haven't done acquisitions. Acquisitions don't fit particularly well into our strategy because there aren't a lot of companies that have our business model. It might make sense in a product category if we didn't have the capability or the company already had a direct orientation, but there really aren't any equivalents. We have been using our cash to reinvest in the business, although our business isn't a particularly capital intensive business, so we've been buying back our own shares. Our share count went from about 3.3 billion shares to under 2.7 billion.

QUESTION: My question is related to mergers and acquisitions. We have about 10 PC companies in Japan. From your perspective, what do you think of the Japanese landscape and what are some of the future trends?

MICHAEL DELL: I actually think the market will consolidate quite a bit, not necessarily by acquisition or merger but through attrition and Darwinian competition. I think you have a number of companies in Japan that have not made a profit in the computing market and probably don't have much hope of making a profit. Now, their fate is really their decision, not ours. We don't have any assumptions about what they will do or won't do; we're focused on serving our customers and providing great value. But, if competitors acted rationally, I think it would be fantastic for Dell and probably very good for their shareholders, too.

MR. NAKATANI: Thank you. We have run out of time, so I'd like to ask one more question. How will the Dell model evolve? What is its future?

MICHAEL DELL: We update and change our business systems all the time. Services in particular are interesting for us. We have about a \$4 billion services business. We focus on hardware-related services. For example, we can reduce the time required to install a storage area network from seven to two days and cut the cost by about one-third by creating a high-volume production kind of environment for close to the box services. That's been growing very rapidly for us.

We also have a managed desktop service, where we're working with financial services companies like AXA here in Japan and globally. We have about 150,000 seats and helped create a standardized process for deploying and supporting desktop computing all over the world. That's very different from higher-end services, but it's clearly a strong evolution of our business.

Last Friday, I was at Boeing – a longstanding Dell customer that has meant \$1 billion in revenue for us over the last 10 years. Today, over 30 percent of this is services-related, so we're not just selling products; we're helping them use IT more efficiently and more effectively.

MR. FUJISAWA: Thank you very much for your time, Mr. Dell. Today's discussion has been extremely valuable for us as business managers and leaders.

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