

DellShares: Dell FY'13 Q3 Performance Review
Rob Williams, Steve Felice, Brian Gladden
Thursday, November 15, 2012

ROB WILLIAMS: Hi. Thanks for joining us today on DellShares. I'm Rob Williams. With me today is Brian Gladden, CFO --

BRIAN GLADDEN: How are you doing, Rob?

ROB WILLIAMS: -- and Steve Felice, chief commercial officer. Thanks for joining us, guys, to talk a little bit about the progress on the strategy in the third quarter and what we're seeing out there with the demand environment, and finish up with a little bit of a view on the outlook.

So, let's start with the strategy, Brian. Give us an update on where we are on the strategy.

BRIAN GLADDEN: Well, you know, Rob, I'd say we continue to make progress on the strategy. This is not a short term execution to the strategy here. The reality is we're seeing lots of proof points that we're making progress here. Enterprise solutions and services for the quarter was up 3 percent, a tough market for that business but I think in almost every case we grew at the market or faster, and we're seeing good profitability, and it's mixing up the business.

Servers and networking are key for the business, and we were up 11 percent in the quarter, with some strong progress in DCS and the hyper-scale data centers. Networking continues to grow very quickly for us with the acquisition of Force10 contributing there.

We've got some great progress this year on acquisitions. So, we've closed six acquisitions that we've spent a fair amount of capital on that, almost \$5 billion, that really begin to reshape software and our cloud efforts, some services activities there, really contributing to enterprise solutions and services.

So, I would say some good progress, and we're going to stick to the strategy. Really important for us to be patient and deliver the results and see the proof points as we move forward here.

ROB WILLIAMS: And we added Quest this quarter, a real foundational asset in software.

BRIAN GLADDEN: Critical to the software business and really the platform we'll build off of, yeah.

ROB WILLIAMS: Yeah. Good, good.

Well, let's talk a little bit about the quarter. Go ahead and give us an update on the third quarter in your view.

BRIAN GLADDEN: Yeah, no, look, we delivered \$13.7 billion on the revenue line, at the lower end of what we talked about coming out of August, in a relatively tough environment. No question we saw some challenging macroeconomic environments and really IT demand dynamics as people are pushing discretionary spending out.

You know, gross margins in general were pretty solid, about flat with where we were if you adjust for some of the things we had in the second quarter, at 22 percent. We're seeing some good mix-up from the investments and things we're doing on the enterprises solutions and services side.

ROB WILLIAMS: Right, right.

BRIAN GLADDEN: Some pressure I would say in gross margins as you think about the PC business and the dynamics.

Pretty good execution on cost, op-ex basically down for the quarter sequentially, but we added significant new investments around the key priorities from a strategy standpoint, and added a month of the Quest costs for the quarter.

ROB WILLIAMS: Right, right.

BRIAN GLADDEN: You know \$0.39 in terms of earnings per share on a non-GAAP basis, and cash flow I would say was a very good highlight for the quarter. We generated \$1.3 billion of cash flow, continue to make progress there, improved cash conversion cycle, and are beginning to see some of the benefits of the new mix of business affecting our cash flow. So, again some progress here in a challenging environment, and we'll continue to drive forward.

ROB WILLIAMS: Yeah. One of the areas where we were relatively mixed in terms of our performance was in the client business. The desktop business did okay, okay against a pretty challenging backdrop, and the notebook business I'd say was below our expectations.

So, Steve, walk us through your view on that business and what you saw really from a business point of view, both in the commercial and the consumer businesses.

STEVE FELICE: Well, Rob, it really was a tough environment, and I'd like to go back a little bit to last quarter, and we started to talk about some of the dynamics we were seeing. And one of the things we all recognized was there was a buildup across the industry in the channel, and we pointed that out last quarter, and we expressed some concern that it might take a while to work that through, and that's exactly what we saw play out this quarter. And it happened around the world.

You know, I think one of the differences in this economic decline versus previous ones is that even the emerging markets are affected. You know, we're used to enjoying some pretty healthy growth rates in the client business in places like China and Brazil, in India and Russia, and we've seen declines in all of those countries.

A lot of the demand remains in the lower end products, the low priced products. There's clearly still some effect of tablets moving into the business. You know, we just decided that it didn't make a lot of sense for us to dive into the low end just to make a unit number.

So, it puts pressure on the business. We have to make sure that we're winning where we can.

We did see a number of competitive wins this quarter that will help us in the future, some large wins with large customers, and we are making a lot of progress and getting our coverage increased and going after more acquisition business across the regions, but it's going to take a little bit of time because you're doing this in an environment where there's a lot of deferrals in purchasing and there's just not a lot of strength in a demand environment.

ROB WILLIAMS: Yeah, definitely. You know, the IDC data for the commercial business globally I think was about down 10 percent in units, and so we roughly held share against obviously a negative 10 percent decline in the overall market. So, again you've just got to kind of dig in and continue to execute your strategy and hold onto the principles that you believe are the right things to do, and I think as we work through the fourth quarter, as we already alluded to would be a little bit of a challenge, and get into the first half of next year I think that we see a better demand environment for sure.

STEVE FELICE: Yeah, absolutely. You're right, the desktop business was down globally, but we were basically holding share.

ROB WILLIAMS: Right.

STEVE FELICE: Notebooks is where we should have done better, and again that hit across the board.

But, you know, when you have an environment where you have a lot of suppliers chasing too little demand, you're going to see some increased competitive pressures. And even in our Latitude end of the business we spent a lot of time defending turf this quarter, and there is price competition going on because everyone is interested in keeping their inventory moving. And so, you know, we have to be pretty cautious in this environment, and make sure that we're sticking with our strategy.

The enterprise side of the business performed well in this environment. So, that's a good indication of where customers are prioritizing their spending, and the fact that we have these advantaged products and terrific solutions, especially with the broadened portfolio now, is an indication that customers want to do business with us. They're just pretty limited in where they can spend their money.

ROB WILLIAMS: Yeah. You know, and the small and medium business market is a perfect example of that. That business did relatively well globally, and really well in the enterprise solutions and services side. So, why don't you start with that?

STEVE FELICE: The SMB business had 15 percent growth in the enterprise solutions and services, and we saw growth in servers, in networking, in the services side of the business that was very healthy, mid-teens to over 20 percent in these categories. So, the strategy and the transformation of the business I think is really manifesting itself with this customer set, with the small and medium business. Even on the client side we're seeing less of a decline there because there is a little more health out of that customer set around the world. So, we're going to continue to invest there, because that's a perfect example of where the strategy is working and we're going to make sure we're covering it properly.

ROB WILLIAMS: What about in the large enterprise or the large commercial space and also the government and state and local government space?

STEVE FELICE: Well, we continue to see fairly significant slowdowns in both areas. In the large enterprise space it's very clear that customers are deferring purchases. Whether you look at these surveys that are done independently from CIOs or even our own discussions with customers we don't really see the pipelines going away, they just keep pushing, they keep pushing out. In fact, I would say that our pipelines remain as healthy as they've been; it's just a question of timing as to when budgets are going to get released.

And, of course, in more localized areas like the U.S. where people are trying to understand things like fiscal cliff and getting the elections out of the way there's clearly a pause in what's going on.

In the public sector we saw a decline of 11 percent. That is seen around the world in terms of budget constraints for government spending.

The federal business in the U.S. is a good example where their fiscal year ends in September. That quarter of spending was pretty healthy actually. But then when we got into October you could see under no budget approval yet and pauses in trying to figure out where budgets are going, we saw a big decline.

In Western Europe throughout the year we've seen a pretty big slowdown in government spending.

So, this is going to be an area that I think will remain challenged until we pull ourselves out of this global economic crisis.

ROB WILLIAMS: Right.

Now, switching over to the consumer side, you know, obviously big transition from Windows 7 to Windows 8, which really affected, as we just talked about, a lot of that inventory push-through that just needed to get worked out of the channel, and we've kind of stayed clear of that for obvious reasons. But we're now there, we've got Windows 8, and I've been using the product, I know Brian is, Michael is, I know you are. I'm pretty pleased with what I'm seeing. I know it's going to take a while, particularly on the commercial side, for these products to get traction, but talk us through what you're hearing about from customers, both on the commercial and the consumer side.

STEVE FELICE: Well, just earlier this week, I was with quite a few customers, and had a chance to get some specific feedback, and it is very positive about Windows 8 itself, and the new form factors that are coming out, and there's great receptivity to Dell's approach to this.

For example, I talked to a lot of customers on the commercial side that were saying, you know, if we're going to use a tablet, for example, in a more mission critical area or something where the availability is critical, we need things like a replaceable battery. And then we talk about the Latitude 10 that has that, and you get terrific reaction to that. Or the security features that haven't been addressed in some of the competitive models; very good reaction to that.

The design of our XPS tablet is really being well received. The XPS 12, that form factor is really unique and customers are -- we saw them using it, and now that you have the great touch capability with Windows 8 you can really see the power of that kind of a product.

And, of course, on the consumer side the all-in-ones, the XPS 27 all-in-one is getting fantastic reviews.

ROB WILLIAMS: Really has got great reviews.

STEVE FELICE: So, reaction from customers, it's very good.

Now, I think we just have to be realistic about this. It's just launched. It's still early days. There are some limited supplies available across the industry. So, this is something that's still going to take a while to play itself out, but I'm really encouraged by what I'm hearing in these early weeks.

ROB WILLIAMS: Great. Well, thanks for the update on that.

Brian, let's wrap it up here. What's your view on Q4 really? We're wrapping up the year, and we put out \$1.70 as our outlook for EPS for the full year. We're sticking with that outlook, and that applies about \$0.38 for the fourth quarter. So, why don't you just talk us through the dynamics in the fourth quarter.

BRIAN GLADDEN: Yeah, I think it's to some extent consistent with what we said in August. We're really not counting on a significant improvement in the environment, some of the things Steve talked about, clearly challenged demand, and we just expect more of the same as we transition through the Windows 8 transition and move into next fiscal year.

So, reality, as you think about demand, we're really counting on some sequential improvement that would be seasonally driven to the 2 to 5 percent range of sequential revenue growth. In terms of profitability, as you said, you know, we're expecting to be at really what we said before, so \$1.70 or better than \$1.70 is really the call.

So, really that's the framework that we're managing through here. Clearly good focus on costs, and that's going to continue to be a priority for us as we move through the cycle, and sticking with a strategy, really not changing really our approach in this kind of an environment.

So, that's really how we're thinking about it to relay finish out the year.

ROB WILLIAMS: Great. Well, again thanks for joining us today, and thank you for joining us on Dell Shares.

I would remind you that this is just a portion of our total earnings materials. I'll encourage you to go to the website and review our press release, our earnings materials related to the conference call, our web deck, et cetera, our GAAP to non-GAAP reconciliations; these are all important things that as investors and owners of the company you should be interested in.

So, again thanks again for joining us, and we look forward to your questions and comments.

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