**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

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| IN RE: APPRAISAL OF DELL INC. | ) ) ) | Consol. C.A. No. 9322-VCL<br>PUBLIC VERSION -- Filed: October 5, 2015 |

# RESPONDENT DELL INC.'S PRE-TRIAL BRIEF

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## INTRODUCTION

On October 29, 2013, Michael Dell and Silver Lake Partners ("Silver Lake") paid $13.75 per share and agreed to the payment of a $0.13 per share special cash dividend to acquire Dell Inc. ("Dell" or the "Company"). In this proceeding, Petitioners ask the Court to ignore the contemporary record, market evidence, applicable law, and even common sense and find that the fair value of Dell as of the merger date was $28.89 per share—an astonishing valuation that is nearly three times the price at which Dell's shares traded before word of a potential transaction reached the market.

Petitioners pursue a litigation-driven valuation resting on a cracked foundation of misplaced assumptions, methodological errors and strained inferences. They tout projections their own expert will not endorse. They provide lip service to the principle that growth requires investment, but ignore that reality in their modeling. They likewise gloss over billions of dollars of non-operating liabilities on Dell's balance sheet and posit a world in which no cash is required to run Dell's operations. They even press a discount rate based on inputs that their expert describes as "idiosyncratic" and unique to him.

Petitioners engage in valuation gymnastics to avoid the real question posed by their extreme valuation: how did the most sophisticated private equity firms in the world which reviewed this transaction somehow miss more than $26 billion in value *above* the merger price? Petitioners do not claim the deal process was defective—in fact, their expert admits there was a "robust" post-signing market check involving more than 70 strategic and financial potential bidders. They do not claim an information void existed that prevented the market from understanding Dell's prospects, challenges and strategies for competing in a deteriorating PC market. Instead, Petitioners simply ask this Court to ignore the vast disparity between the merger price and their desired valuation.

Dell's expert, Glenn Hubbard ("Hubbard"), approached Dell's valuation in a more thoughtful manner. Hubbard took the time to analyze Dell and the markets in which it competes before arriving at a fair value of $12.52 per share.[1] He struck the appropriate balance between management optimism and market realism reflecting the Company's operative reality on October 29, 2013. He also validated his results with alternative methodologies and actual company performance. For the reasons set forth herein, and to be presented at trial, Hubbard's valuation should be accepted as Dell's fair value as of the merger date.

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[1] After Professor Hubbard submitted his opening and rebuttal reports and testified at his deposition, information came to light in other depositions that adds $0.16 to his valuation. Accordingly, Professor Hubbard's point estimate valuation is $12.68 per share.

## STATEMENT OF FACTS

### A. The Parties.

#### 1. Dell

Dell is a global information technology company founded in 1984 by Michael Dell in his dorm room at the University of Texas. JX404 at 4 (Dell FY13 10-K); Michael Dell Deposition, May 14, 2015 at 22:23-24 (Respondent's Appendix ("App.") Tab A). Dell is based in Round Rock, Texas and sells PCs, servers, IT and business services, network and data storage devices, software and peripherals. JX404 at 4-6 (Dell FY13 10-K). Dell is one of the world's largest IT companies with revenues of $56.9 billion in FY2013. *Id*. at 26. Dell went public in 1988 and traded on NASDAQ until the completion of its merger with a Silver Lake affiliate.

#### 2. Petitioners.

Petitioners are a group of mutual funds, hedge funds, risk arbitrageurs and individuals who seek appraisal pursuant to 8 *Del. C.* § 262.

### B. Dell's Uncertain Future at the Time of the Merger.

Dell faced an uncertain future in October 2013. In the United States, it continued to confront a slow recovery from the global financial crisis. JX896 ¶¶ 21-24 (Glenn Hubbard Report, June 5, 2015 ("Hubbard Report")). In Europe, the financial crisis had morphed into a sovereign debt crisis, with many countries undertaking austerity programs. *Id*. ¶ 22. In Asia and Latin America, the frenetic growth of the prior decade had yielded to more modest future forecasts. *Id.* ¶ 23. This global uncertainty impacted Dell's strategy, forecasts and operating results.

### 1. The IT Industry Outlook.

The IT sector was undergoing significant changes in the years leading up to the merger, which presented significant challenges for Dell.

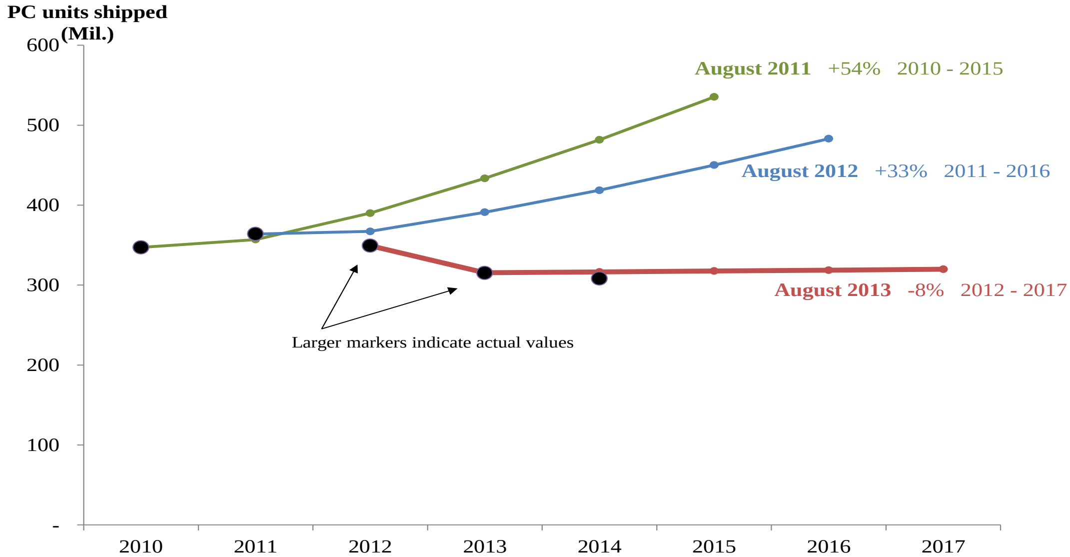
#### a. Tablets and Smartphones.

At the time of the merger, tablet and smartphone sales represented 80 percent of all sales of "smart" devices and were continuing to cannibalize PC sales. *Id.* ¶ 27. Dell failed to anticipate the threat these devices presented to PCs. Dell's tablet revenue totaled only $141 million in FY2013 (less than 0.5% of revenues) at unprofitable margins. *Id.* ¶¶ 28, 30. Dell fared even worse in the smartphone market, which it exited in 2012 after two years of disappointing sales. *Id.* ¶ 29.

#### b. Desktop and Notebook Computers.

Dell's traditional strength had been in desktop and notebook PCs. However, as tablet and smartphone sales increased, PC sales began a precipitous decline, particularly sales for more expensive PCs. *Id*. ¶¶ 31-36. As the following chart illustrates, this threat to the PC business became more acute over time as industry experts like International Data Corporation ("IDC") lowered their five-year forecasts for PCs. *Id*. ¶ 33 & Figure 6.[2]

**IDC Forecasts of PC Unit Shipments**




Sources:
[A] IDC Worldwide Quarterly PC Tracker, August 2011, August 2012, August 2013, and February 2015.
Note:
[1] Actual values reflect realized end-of-period shipment figures.

Also, Dell was facing increased competition due to the market shifting towards lower-end PCs, where Dell was not as strong. JX896 ¶ 32 (Hubbard Report). During this time, competitors such as Lenovo were targeting market share growth by offering products with slim margins. *Id.* This required Dell to price even more aggressively to hold market share at the expense of its margins.[3] As a result of these changes, Dell confronted uncertainty in its primary business line

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2 The pessimistic long-term forecast has not abated since the merger. *See* JX864 (Mar. 2015 IDC Forecast) (forecasting a continuing decline in PC shipments between 2015 and 2019).

3 Brian Gladden, Dell's former CFO, described this approach as "higher revenue and lower profitability." *See* Brian Gladden Deposition, Mar. 13, 2015 at 212:10-14 (App. Tab B).

which still accounted for half of its revenue. JX404 at 109 (Dell FY13 10-K).

**c. Servers.**

Sales of servers and related services were also an important source of revenue for Dell. While the Company was well positioned relative to its competitors, many industry analysts had concerns about the long-term direction of the server business. JX896 ¶ 38 (Hubbard Report). One of the major challenges for Dell was a shift from on-site servers to data storage in the "cloud" offered by third parties such as Amazon Web Services. *Id*. ¶ 37. This shift transferred demand away from existing industry servers to low-cost "white-box" servers, at a time when competitive pressures were already testing margins. *Id*. ¶ 38.

**d. IT Spending.**

The lengthy recovery from the financial crisis also caused companies such as Dell to assess whether the slowdown in IT spending reflected changes in the "refresh cycle" (*i.e.*, the frequency with which PCs are replaced). *Id*. ¶ 40. If refresh cycles were getting longer, as appeared to be the case, that change would have significant ramifications for future sales. *Id*.[4]

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[4] *See also* JX209 at SLP_DELLA00101915 ("Project Dagger – IC Discussion," Nov. 19, 2012) (noting that "the average replacement cycle for desktops and laptops is [approximately] 3.5 years, and has been trending upward in recent years").

### 2. Dell's Transformation Strategy.

Dell understood that it needed to evolve to survive in light of changing marketplace dynamics. In 2009, Dell undertook to transform its business by expanding into the higher-margin services and software businesses. JX35 at 1-2 (Dell FY10 10-K); JX630 at DELLE00779576 (Aug. 2013 Rating Agency Presentation). Beginning in FY2011, the Company acquired eleven businesses to expand its portfolio and extend its core capabilities. JX69 at 26 (Dell FY12 10-K).[5] One of the challenges Dell faced was integrating these acquisitions. By October 2013, there were concerns both internally and externally that Dell's acquisitions were not performing as projected. JX545 at BCG00038647-48 (Dell BOD Presentation, June 12, 2013).[6]

### 3. Dell's Declining Financial Performance.

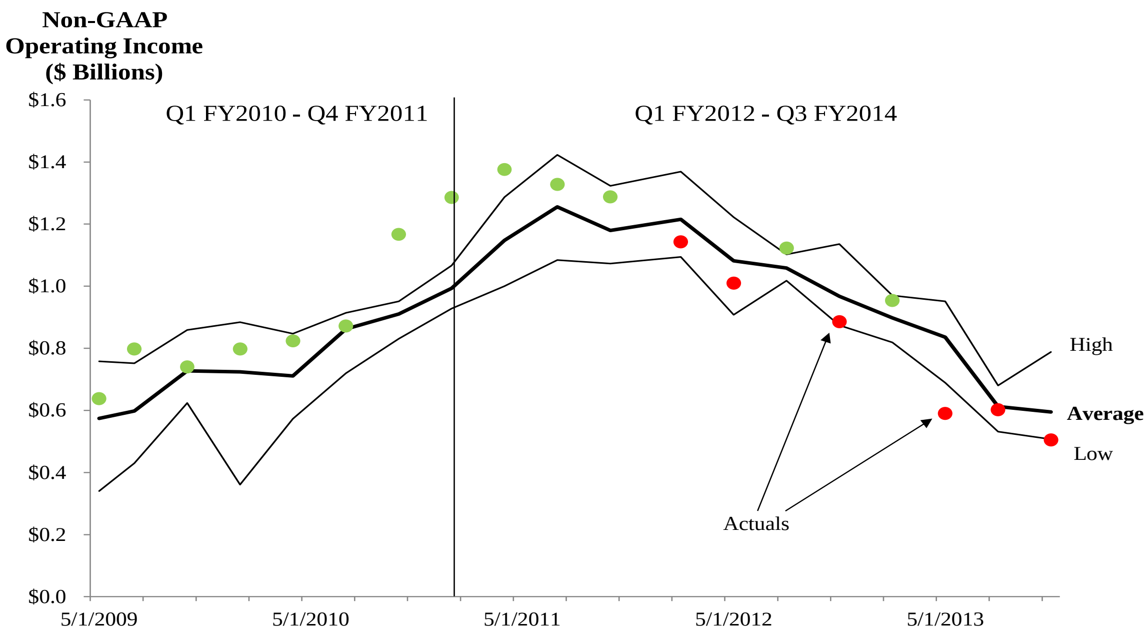
As might be expected given the market uncertainty, Dell's financial performance materially declined in the period leading up to the merger. JX896 ¶¶ 49-50 (Hubbard Report). This deterioration did not go unnoticed. For example,

5 *See also* JX907 at Rebuttal Appendix D (Glenn Hubbard Rebuttal Report, July 24, 2015 ("Hubbard Rebuttal")).

6 *See also* Gladden Dep. at 67:10-14 ("We had a perception that . . . we were overpaying for acquisitions. We didn't have enough R&D spend. We weren't executing well, and our management team was not credible."); Dell 5/14 Dep. at 143:17-145:5 ("I would . . . say in most cases, we did not achieve those aspirational goals. In addition there were costs added to these units to somehow connect them to Dell, which did not deliver the expected returns.").

analysts reduced their price targets, with nearly 90% of them having targets below $13.75 per share at the time the merger was announced, a precipitous decline from the $20 per share level set by many analysts in early 2012. *Id.* ¶ 91. Analysts that followed Dell also cut their FY2014 and FY2015 EBIT forecasts from over $4 billion per year to over $2 billion per year during this period. *Id.* ¶ 88. Even then, Dell consistently underperformed those conservative forecasts. *Id.* ¶¶ 49-50 & Figures 8-9.

**Dell's Quarterly Operating Income Versus Analysts' Forecasts**




Sources:
[A] Equity analysts' expectations about quarterly operating income are from Capital IQ.
[B] Dell quarterly actuals are from quarterly filings, annual filings, and press releases. All actual values represent non-GAAP figures.
Notes:
[1] Quarterly analysts' expectations are measured one month prior to end of the corresponding fiscal quarter.
[2] Green data points represent actuals that exceed mean expectations. Red data points represent actuals that fall below mean expectations.

Dell's struggles were reflected in its stock price, which traded around $13.75 between late 2009 and mid-2012 before declining to the $10.00 range in December

2012 as the PC market deteriorated. Joint Pre-Trial Order at Ex. A. Like many technology companies, this market valuation implied a negative future long term growth rate for Dell. JX896 ¶¶ 66-71 & Figures 14-15 (Hubbard Report).

### C. The Sale Process.

In August 2012, Michael Dell approached Dell's Board of Directors (the "Board" or "BOD") with an interest in exploring a going-private transaction. JX532 at 20 (Def. Proxy Statement, May 30, 2013 ("5/30 Proxy")); JX106 at DELLE00301362 (Aug. 17, 2012 BOD Minutes). In response, Dell's Board took steps to initiate a process designed to evaluate Mr. Dell's interest, as well as other strategic alternatives available to Dell. Mr. Dell made it clear that, if he decided to pursue such a transaction, he would be willing to consider partnering with any party that offered the best transaction for the Company's shareholders. JX532 at 20 (5/30 Proxy).

#### 1. Dell Created A Sound Decision-Making Structure.

##### a. The Special Committee's Clear and Broad Mandate.

Within days of learning of Mr. Dell's interest in a possible going-private transaction, the Board unanimously voted to form an independent committee, consisting of Alex Mandl, Janet Clark, Laura Conigliaro and Kenneth Duberstein (the "Committee" or "SC"). JX107 at DELLE00301364 (Aug. 20, 2012 BOD Minutes). The Committee was given a clear and broad mandate to "take any action in connection with the Proposed Transaction which the . . . Committee determines in its sole discretion to be advisable." JX108 at DELLE00302257 (Aug. 20, 2012 BOD Resolutions). The Committee was granted full and exclusive authority to (i) consider any proposal to acquire the Company involving Mr. Dell and to consider alternative proposals from other parties; (ii) engage independent legal and financial advisors; (iii) make a recommendation to the Board with respect to any proposed transaction; and (iv) evaluate, review and consider other strategic alternatives that may be available to the Company. *Id.* at DELLE00302257-58. The Board resolved not to recommend a transaction for stockholder approval without a prior favorable recommendation by the Committee and directed Dell management to provide the Committee with any information it requested. *Id*. at DELLE00302257.

**b. The Special Committee Was Independent.**

The Committee was comprised of "independent" directors within the meaning of NASDAQ Marketplace Rule 4200(a)(15). JX707 at 18 (Def. Proxy Statement, Sept. 24, 2013 ("9/24 Proxy")). The members were not Dell employees, did not have interests in the proposed transaction different from other stockholders, and did not have any relationships that would interfere with the exercise of their independent judgment in carrying out their responsibilities. JX108 at DELLE00302256 (Aug. 20, 2012 BOD Resolutions).

### c. The Special Committee Members Were Well Qualified.

Beyond their independence and the alignment of their interests with other shareholders, each member of the Committee was well qualified for the role. JX556 at 3 (SC Investor Presentation, June 2013 ("SC Presentation")). Prior to joining the Committee, Mr. Mandl had a long and distinguished business career, with relevant management, finance, and industry experience. JX707 at 16 (9/24 Proxy). Ms. Clark had extensive finance experience as the CFO of Marathon Oil Corporation. *Id*. at 13. Ms. Conigliaro had been a partner and managing director at Goldman Sachs where she served as co-director of Goldman's Americas Equity Research unit and as U.S. Hardware Systems Equity Research Analyst. *Id*. While at Goldman, Ms. Conigliaro had closely followed Dell and the PC industry. And Mr. Duberstein served as Chairman and CEO of The Duberstein Group, a strategic advisory and consulting firm. *Id*. at 14.

### d. The Special Committee Engaged Competent and Independent Advisors.

The implementing Board Resolution authorized and empowered the Committee to retain independent legal counsel and other consultants, including financial advisors. JX108 at DELLE00302257 (Aug. 20, 2012 BOD Resolutions). The Committee retained Debevoise & Plimpton LLP ("Debevoise") as legal counsel and J.P. Morgan Securities LLC ("J.P. Morgan") as its financial advisor.

JX116 at DELLE00301369 (Aug. 24, 2012 SC Minutes); JX124 at DELLE00301376 (Aug. 31, 2012 SC Minutes). The Committee also subsequently retained Evercore Group L.L.C. ("Evercore") as a second financial advisor to run the go-shop and The Boston Consulting Group, Inc. ("BCG") to assist the Committee in evaluating strategic alternatives. JX200 (BCG Engagement Letter, Nov. 12, 2012); JX277 (Evercore Engagement Letter, Jan. 10, 2013) (providing that, if Dell entered into a definitive agreement that constituted a "superior proposal," Evercore would earn up to $30 million).

### 2. The Special Committee Employed A Fair and Robust Transaction Process.

With its broad mandate in place, and with guidance and assistance from Debevoise, J.P. Morgan, Evercore and BCG,[7] the Committee employed a robust process to evaluate the going-private transaction proposed by Mr. Dell, as well as other strategic alternatives available to the Company.

#### a. The Special Committee Created and Maintained a Level Playing Field.

Mindful that Mr. Dell was a potential participant in a transaction, the Committee took steps to ensure a level playing field.

[7] Goldman Sachs also made presentations to the Committee regarding strategic alternatives. *See* JX166 at DELLE00301394-95 (Oct. 10, 2012 SC Minutes).

*First*, the Committee required Mr. Dell to enter into a confidentiality agreement that (i) prohibited him from proposing a transaction involving the Company unless invited to do so by the Committee; (ii) prohibited him from entering into agreements with any party, including exclusivity arrangements with financing sources, regarding a transaction involving the Company without the Committee's consent; (iii) required him to work in good faith with other potential sponsors if requested to do so by the Committee and to refrain from taking any actions that would prevent him from doing so; (iv) required him to represent that his evaluation of a possible transaction would not interfere with the performance of his duties as CEO of the Company; and (v) prohibited him from sharing any confidential information with any other party, including the sponsors. JX125 (Michael Dell Confidentiality Agreement, Aug. 31, 2012). These restrictions neutralized Mr. Dell's influence over the process and preserved its fairness. JX119 at DELLE00408843 (Email between Jeff Rosen and Alex Mandl, Aug. 27, 2012) (noting that Mr. Dell's NDA allowed Committee to "retain the ability . . . to conduct any process it thought appropriate and feasible [and] to move forward with a transaction or to reject one.").

*Second*, the parties included an unaffiliated vote provision in the Merger Agreement requiring the merger to "be adopted by holders of a majority of the outstanding shares of common stock entitled to vote thereon not held by Mr. Dell, certain related family trusts and members of management, or other persons having an equity interest in . . . [Dell]." JX532 at 40; *see also* JX349 at DELLE00499132-33 (Merger Agreement § 3.21).

*Third*, Mr. Dell entered into a voting agreement in which he and his affiliates agreed to "vote their shares of Common Stock in the same proportion to the number of shares voted by the Company's unaffiliated stockholders" in favor of either (i) a superior proposal if the Merger Agreement was terminated and the Company entered into a definitive agreement with respect to such superior proposal; or (ii) the adoption of the Merger Agreement in the event of a change of recommendation. JX532 at 123-24 (5/30 Proxy); *see also* JX944 at DELLE00715064 (Michael Dell Voting Agreement, Feb. 5, 2013).

*Fourth*, Mr. Dell did not participate in the deliberations of the Committee and abstained from the Board's vote on whether the transaction should be recommended. JX532 at 42, 82, 113 (5/30 Proxy). He also represented to the head of the Committee, Alex Mandl, that, in the event shareholders failed to approve the transaction, he remained committed to the Company and would work to increase stockholder value. *Id.* at 31, 37.[8]

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[8] *See also* JX549 (Email from Alex Mandl, June 18, 2013 (describing "a constructive conversation with MD" during which he "indicated his interest to continue in his current role" if shareholders failed to approve transaction).

And in addition to the above, Mr. Dell ultimately agreed to receive less compensation for his own shares as a means of permitting higher bids for Dell. *Id.* at 38, 82.[9]

#### b. The Special Committee Considered a Wide Range of Strategic Alternatives.

With guidance from its legal and financial advisors, the Committee evaluated a number of strategic alternatives to a transaction with Mr. Dell, including but not limited to (i) a leveraged buyout; (ii) a separation of the Company's end-user computing ("EUC") and enterprise solutions and services ("ESS") businesses; (iii) a sale of Dell Financial Services ("DFS"); (iv) a spin-merger transaction involving EUC and a strategic company; and (v) a return of capital strategy through a share repurchase or cash dividend funded with new debt and/or existing cash. *See, e.g.*, JX167 at DELLE00301704 (Goldman Sachs Presentation, Oct. 10, 2012).[10] The Committee also explored the possibility of continuing to execute management's long-term plan as a public company, potential changes to that plan, and adjustments to the management team. *See, e.g.*, JX233 at DELLE00302409 (Dec. 6, 2012 BOD Minutes). In the end, the Committee

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[9] Mr. Dell agreed to roll over his shares and those of his affiliates at $13.36 per share, or $0.39 less than the final per share merger consideration paid to unaffiliated stockholders. *Id.*

[10] *See also* JX168 at DELLE00302215 (Oct. 10, 2012 SC Minutes); JX182 at DELLE00302219-20 (Oct. 27, 2012 SC Minutes); JX230 at DELLE00302230 (Dec. 5, 2012 SC Minutes).

concluded that the transaction with Mr. Dell provided the best opportunity to maximize stockholder value. JX637 at DELLE00302493 (Aug. 2, 2013 SC Minutes).

### 3. The Special Committee Achieved The Highest Price Reasonably Available.

The pre-signing market canvass and the broad post-signing go-shop utilized by the Committee further highlight the integrity of the transaction process.

#### a. The Pre-Signing Market Canvass.

The Committee conducted a lengthy and robust process to analyze the available strategic options and followed reasonable steps designed to maximize shareholder value. The Committee decided to allow Silver Lake and KKR & Co. L.P. ("KKR") to conduct due diligence in contemplation of possible bids. The Committee believed these were strong candidates. Silver Lake was a major PE firm with extensive technology experience. JX532 at 23 (5/30 Proxy). Silver Lake principal, Egon Durban, had initiated the going private idea with Mr. Dell. KKR likewise had considerable experience investing in technology companies. *Id.* Michael Dell knew KKR co-founders Henry Kravis and George Roberts. Roberts was a neighbor of Mr. Dell and had validated the feasibility of Dell going private.

At the outset, the Committee required Silver Lake and KKR to enter into confidentiality agreements which prohibited them from proposing a transaction unless invited to do so by the Committee or from entering into agreements with other parties concerning a transaction without the Committee's consent. JX130 (Silver Lake Confidentiality Agreement, Sept. 4, 2012); JX129 (KKR Confidentiality Agreement, Sept. 4, 2012).

On October 23, 2012, Silver Lake and KKR submitted their initial proposals of \$11.22-\$12.16 per share and \$12.00-\$13.00 per share, respectively. JX176 (Oct. 23, 2012 Silver Lake Proposal); JX177 (Oct. 23, 2012 KKR Proposal). The Committee rejected these proposals and indicated that a materially higher price was a prerequisite to moving forward. JX532 at 28 (5/30 Proxy). On December 4, 2012, Silver Lake presented an updated proposal for \$12.70 per share. JX223 (Dec. 4, 2012 Silver Lake Proposal). The Committee again stated that it would consider a transaction only at a materially higher price. JX532 at 32-33 (5/30 Proxy).

On that same day, KKR notified the Committee that it would not be submitting an updated proposal. *Id.* at 30. KKR cited as the reason the inability to "get [its] arms around the risks of the PC business." JX224 (Email from Alex Mandl, Dec. 4, 2012). Upon learning of KKR's decision, Michael Dell reiterated to the Committee his willingness to work with other interested parties. *Id.* (reporting on "a full conversation" with Mr. Dell regarding available "alternatives" during which he expressed "his willingness to join up with whoever").

In the days that followed, the Committee consulted with its advisors to identify other potential bidders and determined that it should contact TPG Capital ("TPG"). JX235 at DELLE00302253 (Dec. 6, 2012 BOD Minutes). TPG also had prior technology experience and had invested in the sector in 2005 when it backed Lenovo. The Chair of the Committee personally knew David Bonderman, the head of TPG, and called him directly to discuss the opportunity.

TPG expressed interest in a possible transaction and, for several weeks, it conducted due diligence and met with management. *See, e.g.*, JX1200 at DELLE00411507-08 (Email from Kurt Simon to Alex Mandl, Dec. 7, 2012) (forwarding proposed timetable for TPG due diligence). TPG indicated on multiple occasions that an offer would be forthcoming, but ultimately declined to bid. *See, e.g.*, JX1201 at DELLE00406759 (Email from Alex Mandl, Dec. 19, 2012) (noting Committee would "hear from TPG this coming Friday").[11] Like KKR, TPG cited the risks and uncertainties of the PC business as the reason for its withdrawal. JX1203 at JPM_0344530 (Email from Kurt Simon to Alex Mandl, Dec. 23, 2012) (reporting that TPG could not "get comfortable with the negative trends . . . and trying to call the bottom [of the PC market]").

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[11] *See also* JX1202 at DELLE00406756 (Email from Jeff Rosen to SC, Dec. 21, 2012) (explaining TPG proposal delayed because "they need a few more days").

The Committee and its advisors considered whether to invite yet another party to make a bid at this stage of the process. They determined that the risk of a leak was already substantial and they might have more leverage to bring in another bidder if they already had an offer in hand. *See* JX532 at 34 (5/30 Proxy).

From December 2012 to February 2013, the Committee continued its negotiations with Silver Lake, which led to revised proposals from Silver Lake for $12.90 per share (JX309 (Jan. 15, 2013 Silver Lake Proposal)), $13.25 per share (JX532 at 38 (5/30 Proxy)), $13.60 per share (JX320 at DELLE00301360 (Jan. 24, 2013 SC Minutes)), $13.60 per share with a guaranteed stockholder dividend (JX532 at 38 (5/30 Proxy), and $13.75 per share with no guaranteed dividend (JX327 at DELLE00302261 (Feb. 3, 2013 SC Minutes)). The Committee rejected each offer despite Silver Lake's indication on at least two occasions that the proposal was its "best and final offer." JX320 at DELLE00301360 (Jan. 24, 2013 SC Minutes); JX327 at DELLE00302262 (Feb. 3, 2013 SC Minutes).

Finally, on February 4, 2013, Silver Lake increased its offer to $13.65 per share, with a guaranteed stockholder dividend. JX335 at DELLE00302152 (Feb. 4, 2013 SC Minutes). After receiving and reviewing fairness opinions from J.P. Morgan and Evercore, the Committee unanimously resolved to recommend to the Board that it accept Silver Lake's proposal. *Id.* at DELLE00302155. The Board (with Mr. Dell abstaining) then unanimously voted to approve the transaction and recommend it to Dell's stockholders. JX337 at DELLE00302275-80 (Feb. 4, 2013 BOD Minutes).[12] In total, as of February 5, 2013, the Committee successfully negotiated six increases to the merger consideration totaling $2.66 per share or over $4 billion in additional value. JX556 at 6, 8 (SC Presentation).[13] Even as it did so, the Committee continued to evaluate various strategic alternatives that might be available to Dell. JX532 at 20, 23, 25-26, 30, 36-37, 41 (5/30 Proxy).[14]

#### b. The Post-Signing Go-Shop.

The Committee also negotiated for a go-shop that provided a 45-day window during which the Company could solicit and negotiate with other potential bidders. JX349 (Merger Agreement § 5.3(f)(i)).[15] The Merger Agreement permitted the Company to continue discussions with parties that had made proposals during the go-shop and to respond to and negotiate with respect to certain unsolicited

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12 On July 23, 2013, Mr. Dell proposed changing the Merger Agreement so that shares not voting would not be counted as votes against the proposed merger. JX612 at DELLE00302465 (July 23, 2013 SC Minutes). The Committee recommended this amendment on the condition that the merger consideration increase from $13.65 to $13.75 per share and that both a $0.13 special dividend and the $0.08 third quarter dividend would be paid. JX631 at DELLE00310928-29 (Aug. 1, 2013 BOD Minutes).

13 *See also Gesoff v. IIC Indus., Inc.*, 902 A.2d 1130, 1148 (Del. Ch. 2006) (holding that negotiations "need not . . . be a 'death struggle.' But they should be vigorous and spirited, and provide evidence that the special committee and the [interested party] are not colluding to injure the minority stockholders.").

14 *See also* JX556 at 29-36 (SC Presentation).

15 *See also In re Topps Co. S'holders Litig.*, 926 A.2d 58, 86 (Del. Ch. 2007) (40-day go-shop "left reasonable room for an effective post-signing market check").

proposals made after the go-shop. *Id.* (Merger Agreement § 5.3). This provided "a real world market check" on the transaction price.

During the go-shop, Evercore (which stood to receive up to $30 million if it successfully solicited a superior transaction) contacted 67 parties, including 20 strategic parties, 17 financial sponsors, and 30 other parties, to solicit interest in a transaction (JX424 at JPM_0202735 (Go-Shop Update, Mar. 24, 2013)). Evercore also received unsolicited inbound inquiries from two strategic parties and two financial sponsors. JX532 at 43 (5/30 Proxy). Of those 71 parties, 11 expressed interest in evaluating a possible transaction. *Id.*[16] Evercore and the Committee worked with those parties in an attempt to solicit a "Superior Proposal," even offering up to $25 million in expense reimbursement to support due diligence efforts. JX532 at 48 (5/30 Proxy). The robust nature of this process is reflected in Evercore's contact logs and regular progress reports delivered to the Committee.[17] Hewlett-Packard ("HP") was specifically targeted after an analysis was performed

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16 *See also In re Morton's Rest. Grp., Inc. S'holders Litig.*, 74 A.3d 656, 676 (Del. Ch. 2013) (finding it "not conceivable" that board acted in bad faith where "two qualified investment banks and reache[d] out to over 100 potential buyers in an extended effort to induce competition and get the best price").

17 *See, e.g.*, JX364 (Go-Shop Contact Log, Feb. 10, 2013); JX380 (Go-Shop Update, Feb. 22, 2013); JX386 (Go-Shop Update, Mar. 1, 2013); JX395 (Go-Shop Update, Mar. 6, 2013); JX422 (Go-Shop Update, Mar. 24, 2013).

of HP's ability to consummate such a transaction. JX532 at 44.[18] Although HP was given access to due diligence materials, it did not submit a bid.

The Committee ultimately received two proposals during the go-shop that it determined could lead to a "Superior Proposal": one from Carl Icahn and another from the Blackstone Group L.P. ("Blackstone"). JX532 at 47-48 (5/30 Proxy).[19] Blackstone reached out to Evercore even before the go-shop began to explore a possible transaction. *Id.* at 38. For over two months, Blackstone engaged in extensive due diligence and received reimbursement of its diligence expenses. *Id.* at 45-48.[20] Over the course of this lengthy and detailed process, Blackstone involved between 300 to 400 principals, advisors and financing sources in its diligence activities and was given greater access to Dell executives than Silver Lake received. JX452 at DELLE00405877 (Process Update, Apr. 5, 2013); JX465 at EVERCORE00151760 (Process Update, Apr. 12, 2013).[21] Blackstone's efforts

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18 *See also* JX1205 at DELLE00239964 (Email from Kurt Simon to Alex Mandl, Feb. 22, 2013) (forwarding materials regarding HP's ability to raise cash needed to finance a transaction).

19 Icahn floated a number of alternative proposals for Dell, which the Committee considered. Mr. Mandl met directly with Icahn as did Mr. Dell. Icahn's team also participated in due diligence and had its expenses reimbursed. But at the end of the day, Icahn never made a formal offer to acquire the Company.

20 *See also* JX1209 at DELLE00406286 (Email from Alex Mandl, Mar. 19, 2013) (discussing $25 million expense reimbursement to Blackstone as "design[ed] to help level the playing field").

21 *See also* JX461 at DELLE00313996 (Email between Larry Tu and Alex Mandl, Apr. 11, 2013) (comparing Blackstone's hours of meetings with Dell

were led by Dave Johnson, Dell's former Senior Vice President for Strategy until January 2013, who had previously been with IBM. While at Dell, Mr. Johnson was responsible for the acquisitions the Company made to foster its transformation strategy. If anyone outside of the Company knew Dell, it was Mr. Johnson. He had also previously worked with Evercore on a prior Dell acquisition.

Blackstone also sought and received permission from the Committee to pursue a possible partnership with other entities to strengthen a potential bid. With the Committee's consent, Blackstone worked with Francisco Partners III, LP, TPG, Insight Venture Partners, and Riverwood Capital on formulating a possible bid. JX532 at 44-46, 48 (5/30 Proxy).[22] Blackstone also received permission to engage with potential financing sources and hired 10 advisory firms to assist with due diligence. *Id.* at 48. In addition, the Committee had received an indication of interest from GE Capital regarding the purchase of DFS, which the Committee relayed to Blackstone in an effort to facilitate a Blackstone bid. *Id.* at 38, 43, 46; JX419 (GE Indication of Interest, Mar. 21, 2013).

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management to hours of time Silver Lake received); *id.* at DELLE00313995 (Michael Dell states that he "spent more time with Blackstone than any of the other participants and will continue to make [him]self available.").

[22] *See also* JX1206 at DELLE00411243-45 (Email from William Regner to Alex Mandl, Mar. 3, 2013) (discussing Blackstone partnering with TPG which "should help strengthen Blackstone's bid."); JX1207 at DELLE00411171-73 (Email from Roger Altman to Alex Mandl, Mar. 3, 2013) (recommending that Blackstone join with others because "it will potentially serve Dell shareholders for this pairing to go forward").

Prior to the end of the go-shop, Blackstone proposed an alternative transaction that the Committee determined could result in a Superior Proposal. JX532 at 46-48 (5/30 Proxy).[23] However, on April 10, 2013, IDC issued a report which stated that total worldwide PC shipments in the first quarter of 2013 had declined by approximately 14% as compared to the first quarter of 2012. JX1210 at JPM_0024713 ("PC Shipments Post the Steepest Decline Ever in a Single Quarter, According to IDC," Apr. 10, 2013). Blackstone expressed concern to Alex Mandl about this report. JX464 at DELLE00302441 (Apr. 12, 2013 SC Minutes). A few days later, Blackstone withdrew from the process citing: "(1) an unprecedented 14 percent market decline in PC volume in the first quarter of 2013, its steepest drop in history, and inconsistent with Management's projections for modest industry growth; and (2) the rapidly eroding financial profile of Dell." JX476 (Blackstone Withdrawal Letter, Apr. 18, 2013).

### D. The Special Committee Negotiates a Revised Merger Agreement and the Transaction Closes.

Following the go-shop, the Committee successfully negotiated a seventh increase in merger consideration and entered into a revised Merger Agreement with Mr. Dell and Silver Lake on August 2, 2013. JX654 at 22-24 (Revised Def. Proxy, Aug. 14, 2013 ("8/14 Proxy"). Under the revised Merger Agreement,

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[23] *See also* JX417 at DELLE00432108 (Letter from Chinh Chu, Mar. 22, 2013) (expressing "enthusias[m] about pursuing this opportunity.").

Silver Lake agreed to (i) increase the proposed purchase price from $13.65 to $13.75 per share; (ii) provide for the payment of a $0.13 per share special dividend at or before closing of the merger; and (iii) guarantee that Dell's third quarter dividend of $0.08 per share would be paid at or before closing. JX620 at DELLE00302428 (July 31, 2013 SC Minutes); JX637 at DELLE00302489 (Aug. 2, 2013 SC Minutes). The $13.88 per share consideration represented a premium of approximately 28% above Dell's closing stock price on January 11, 2013, the last trading day before reports of a possible transaction were first published, a premium of approximately 37% above Dell's enterprise value as of that date, and a premium of approximately 39% above the 90-day average closing price. JX654 at 25 (8/14 Proxy). On September 12, 2013, at a special stockholder's meeting, the holders of a substantial majority of the disinterested shares voting on the matter approved the revised Merger Agreement. JX702 (Dell Form 8-K, Sept. 18, 2013). The transaction closed on October 29, 2013. JX729 (Dell Form 8-K, Oct. 29, 2013).

### E. Petitioners File Their Appraisal Petitions.

Between October 2013 and February 2014, thirteen appraisal actions were filed in this Court and subsequently consolidated. Trans. ID 55284281. Since then, the Court has dismissed a number of these claims in a series of Orders dated June 27, 2014, September 10, 2014, May 13, 2015 and July 28, 2015. Trans.

IDs 55652563, 56013130, 57235523, 57235488, 57235442, 57235370, 57618121. A motion for summary judgment remains pending as to certain claims linked to shares voted in favor of the merger. Trans. IDs 57633321, 57738109.

**LEGAL STANDARD**

In an appraisal proceeding, the Court is tasked with determining "the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value." 8 *Del. C.* § 262(h). The Court must "take into account all relevant factors." *Id*. Those include "market value, asset value, dividends, earning prospects, the nature of the enterprise and any other facts which were known or which could be ascertained as of the date of merger and which throw any light on future prospects of the merged corporation." *Tri-Cont'l Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950). "The entity must be valued as a going concern based on its business plan at the time of the merger, and any synergies or other value expected from the merger giving rise to the appraisal proceeding itself must be disregarded." *Global GT LP v. Golden Telecom, Inc.*, 993 A.2d 497, 507 (Del. Ch. 2010), *aff'd*, 11 A.3d 214 (Del. 2010). The Court examines the company's operative reality at the time of the merger and "may consider all relevant, non-speculative factors bearing on [the company's] value as of the merger date." *Del. Open MRI Radiology Assocs., P.A. v. Kessler*, 898 A.2d 290, 310 (Del. Ch. 2006) (citing *Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd.*, 847 A.2d 340, 356-57 (Del. Ch. 2004)).

## ARGUMENT

### A. Shares Voted In Favor of The Merger Are Not Eligible For Appraisal.

As detailed in its motion for summary judgment (Trans. ID 57633321), Dell is entitled to judgment as a matter of law as to more than 30 million shares seeking appraisal that were voted in favor of the transaction. *See* 8 *Del. C.* § 262(a) (requiring petitioner to have "neither voted in favor of the merger or consolidation nor consented thereto in writing pursuant to § 228 of this title"). "The Delaware Supreme Court has endorsed a principle of strict construction" of the appraisal statute and a dissenting stockholder's failure to comply with the technical requirements of the statute is not excusable. *In re Appraisal of Dell Inc.*, 2015 WL 4313206, at *10 (Del. Ch. July 13, 2015, revised July 30, 2015).[24] Accordingly, Dell is entitled to judgment as a matter of law as to those shares.

### B. Dell's Fair Value on the Merger Date Was $12.68 Per Share.

Dell retained Glenn Hubbard as an expert witness to provide testimony concerning the fair value of Dell's shares as of October 29, 2013. Hubbard is Dean

[24] *See also Berger v. Pubco Corp.*, 976 A.2d 132, 144 (Del. 2009); *Konfirst v. Willow CSN, Inc.*, 2006 WL 3803469, at *2 (Del. Ch. Dec. 14, 2006) ("Appraisal rights are created by statute and, in order to partake in those rights, strict compliance with the precise statutory standards is essential.").

of the Graduate School of Business of Columbia University (where he is also Professor of Finance and Economics), a past Chairman of the President's Council of Economic Advisors, and a recognized expert on finance and economics. JX896 ¶¶ 2-5 (Hubbard Report). Hubbard submitted his opening report on June 5, 2015, and a rebuttal report on July 24, 2015. These reports are detailed and extensively sourced from both the evidentiary record and documents available in the public domain.

Hubbard concluded that the fair value of Dell as of the merger date was $12.68 per share. *Id.* ¶ 8. He reached this opinion after performing an independent valuation using a discounted cash flow ("DCF") analysis. He tested his valuation by reviewing other methodologies and market indicators, including the merger price, analysts' projections, a DCF valuation based on Silver Lake projections prepared in anticipation of operating as a private company, and a comparable companies analysis. *Id.* In each case, the results corroborate his opinion. *Id.*

**1. DCF Analysis.**

The DCF methodology is a widely accepted valuation methodology. *See, e.g.*, *Owen v. Cannon*, 2015 WL 3819204, at *16 (Del. Ch. June 17, 2015) ("[T]he DCF . . . methodology has featured prominently in this Court because it 'is the approach that merits the greatest confidence' within the financial community.")

(quoting *Cede & Co. v. JRC Acq. Corp.*, 2004 WL 286963, at *2 (Del. Ch. Feb. 10, 2004)). It requires: (i) reasonable and realistically achievable projections over a set period of time; (ii) a terminal value reflecting cash flows beyond the projection period; and (iii) a discount rate based on the company's weighted average cost of capital. *In re Appraisal of Orchard Enters., Inc.*, 2012 WL 2923305, at *12 (Del. Ch. July 18, 2012). The resulting enterprise value must then be converted to equity value by adjusting for non-operating assets and liabilities. JX73 at Chapter 16 (Aswath Damodaran, *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset* (3d ed. 2012)).

**a. Projection Period.**

A DCF analysis requires reliable projections to produce an accurate result. *See* Tim Koller, Marc Goedhart, & David Wessels, *Valuation: Measuring and Managing the Value of Companies* at 303 (5th ed. 2010) (a DCF "is only as accurate as the forecasts it relies on"). Hubbard noted the difficulty of that task in this case due to the following factors:

> (i) the rapidly deteriorating and highly uncertain environment facing the market for PCs and, to a lesser extent, servers at the time of the transaction, and (ii) the significant uncertainty surrounding the success and timing of the transformation of the Company from predominant reliance on its EUC business to a primary focus on "New Dell," with the focus on services, software, and providing more complete IT solutions to small and mid-size business customers.

JX896 ¶ 135 (Hubbard Report). Nevertheless, both he and Petitioners' expert agree that two sources of projections are potentially appropriate for this valuation.

**i. BCG Projections.**

In September 2012, Dell senior management prepared a top-down projection based on limited information and input from the Company's various business units. Three months later, the Committee became concerned that while those projections "might be useful to help negotiate a higher price from bidders, [they] were less helpful in assisting the Committee in evaluating the Company's alternatives to a going private transaction because of the Committee's belief that some of the assumptions underlying the projections were overly optimistic." JX238 at DELLE00302233 (Dec. 11, 2012 SC Minutes). Accordingly, the Committee tasked BCG with providing an independent and objective view as to the Company's likely future performance if it were to remain a publicly held entity. *Id*.[25]

Over the next two months, BCG developed and refined a detailed forecast model based on the current business mix and geographical distribution of the Company's portfolio, taking into account, among other factors, industry prospects and the Company's competitive position within the industry (the "Base Case").

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25 *See also* JX258 at DELLE00301351 (Jan. 2, 2013 SC Minutes); Lutao Ning Deposition, Apr. 29, 2015, at 16:22-17:5 (App. Tab C).

JX532 at 100 (5/30 Proxy).[26] BCG also developed forecasts reflecting the incremental effect of certain management initiatives and market sensitivities on the Base Case, assuming in one case that 25% of potential phased productivity cost reductions would be attained (the "25% Case"), and in another case that 75% of such reductions would be attained (the "75% Case"). *Id.* Hubbard reviewed the detailed BCG spreadsheets and discussed those projections with the BCG personnel who prepared them. JX896 ¶ 156 (Hubbard Report). After considering both the positive attributes and necessary limitations of BCG's projections, Hubbard concluded that they were an appropriate starting point for his DCF analysis. *Id*. ¶¶ 156-75.

Hubbard did not end his inquiry there, however. He carefully considered the appropriateness of these projections in light of: (i) the further deterioration in the PC market leading up to the merger; and (ii) the cost savings initiatives underway at the Company. *Id.* ¶¶ 145-75. As to the former, Hubbard concluded that updating the PC forecasts with the latest IDC data—*i.e.*, the same data used in BCG's analysis—was the most appropriate way to avoid subjective market

[26] *See also* JX344 at DELLE00543449 ("Project Denali: Compendium of presented materials," Feb. 5, 2013).

adjustments while remaining faithful to his mandate to value Dell as of the merger date. *Id.* ¶¶ 192-94.[27]

As to Dell's publicly announced cost savings initiative, Hubbard reviewed the Company's various cost savings programs, Dell's historical success in translating cost savings to the bottom line, and the views of market participants as to the realistic amount of cost savings that ultimately might reach the bottom line in light of offsetting operating expense investment demands, margin erosion and other competitive pressures. *Id.* ¶¶ 165-75.

Ultimately, Hubbard opted for a conservative approach to the BCG projections and assumed that, notwithstanding its past record on cost savings initiatives that indicated a lower amount, 25% of potential cost savings would fall directly to the bottom line. Hubbard's decision to use the 25% Case rather than the Base Case was further reinforced by the views of market participants at the time of the transaction. *See, e.g.*, JX335 at DELLE00302155 (Feb. 4, 2013 SC Minutes) (Evercore told Committee "that the BCG 25% productivity case represented the most likely scenario . . . that had been presented to the Committee"); *id.* (J.P.

[27] Because of the way BCG created its model, this adjustment also required an adjustment to the model's Support & Deployment (S&D) revenue. *Id*. ¶¶ 195-96. Hubbard used the same attachment rate provided to BCG and utilized in Dell's September 2012 model (*i.e.*, 17%). This rate is also very close to the attachment rate (17.9%) used in Silver Lake's model. JX907 ¶¶ 42-43 (Hubbard Rebuttal Report).

Morgan advised Committee that it had "independently reached the same conclusion regarding the BCG 25% productivity case.").

**ii. Bank Case Projections.**

Hubbard also considered projections prepared by Silver Lake which were submitted to lenders to secure financing for the transaction (the "Bank Case"). Because those projections reflect the operation of Dell as a private company, however, Hubbard concluded that they would require a number of subjective adjustments before they could be used to value Dell as a public company. JX896 ¶ 280 (Hubbard Report). Accordingly, he concluded that the Bank Case was instructive as corroboration for his primary valuation using the 25% Case, but less reliable as a standalone set of projections. *Id*. ¶ 187.

**b. Terminal Period.**

In addition to reviewing free cash flows for the projection period, Hubbard also had to determine Dell's free cash flows for the post-projection period to arrive at his terminal value. *See Golden Telecom*, 993 A.2d at 511 ("[A] terminal value is calculated to predict the company's cash flow into perpetuity.").[28] The two most common approaches for calculating the terminal value are the perpetuity growth

[28] *See also* JX73 at 321 (Aswath Damodaran, *Investment Valuation*)) ("Since firms have infinite lives, you apply closure to a valuation by estimating cash flows for a period and then estimating a value for the firm at the end of the period – a terminal value.").

model and the exit multiples approach. *Merion Capital, L.P. v. 3M Cogent, Inc.*, 2013 WL 3793896, at *21 (Del. Ch. July 8, 2013). In the former, cash flows are assumed to grow at a constant growth rate in perpetuity. Shannon P. Pratt & Roger J. Grabowski, *Cost of Capital: Applications and Examples*, at 40-44 (5th ed. 2014). In the latter, the "value of a firm in a future year is estimated by applying a multiple to the firm's earnings and revenues in that year." JX73 at 305 (Damodaran, *Investment Valuation*). Although the Court has accepted both approaches, the perpetuity growth model is the "preferred method of estimating a perpetual growth rate." *In re PNB Hldg. Co. S'holders Litig.*, 2006 WL 2403999, at *31 (Del. Ch. Aug. 18, 2006).[29]

For the post-projection period, Hubbard used a three-stage DCF model incorporating a 5-year transition period to allow for normalization of cash flows,[30] a 2% perpetuity growth rate with necessary investment and a terminal tax rate of

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29 *See also* JX73 at 306 (Damodaran, *Investment Valuation*) ("[U]sing multiples to estimate terminal value, when those multiples are estimated from comparable firms, results in a dangerous mix of relative and discounted cash flow valuation."); Pratt, *et. al.*, *Cost of Capital: Applications and Examples*, at 1195 ("[U]se of a market-derived multiple for calculation of the terminal value is not appropriate, as it mixes elements of the market and income approaches and does not represent a true income approach.").

30 *Orchard Enters.*, 2012 WL 2923305, at *15 ("[B]ecause the terminal value is meant to capture the present value of all future cash flows of the company, typically the net cash flow figure used to generate the terminal value should be normalized, rather than 'unrealistically extrapolate[] [a company's] short run circumstances into perpetuity.'").

35.8% based on the work performed by Dell's expert, Stephen Shay ("Shay").[31] These were "middle of the fairway" assumptions reflecting the Company's optimism that it would succeed in transforming Dell.

**c. Discount Rate.**

Once free cash flows are calculated for the projection and terminal periods, those cash flows must then be discounted back to the present at the rate of the company's weighted average cost of capital. *See, e.g.*, *3M Cogent*, 2013 WL 3793896, at *10 ("The basic premise underlying the DCF methodology is that the value of a company is equal to the value of its projected future cash flows, discounted to the present value at the opportunity cost of capital.").[32] Hubbard used the capital asset pricing model to derive his cost of equity. *In re Rural Metro Corp. S'holders Litig.*, 88 A.3d 54, 108 (Del. Ch. 2014) (noting that the capital asset pricing model or "CAPM" "should be used where it can be deployed

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31 JX896 ¶¶ 200-02 (Hubbard Report) (transition period); *id.* ¶¶ 203-13 (investment necessary to support forecasted growth); *id.* ¶¶ 214-19 (perpetuity growth rate); *id.* ¶¶ 222-23 (terminal tax rate); *see also* JX922 ¶¶ 41-46 (Revised Stephen Shay Report Aug. 26, 2015).

32 *See also Andaloro v. PFPC Worldwide, Inc.*, 2005 WL 2045640, at *9 (Del. Ch. Aug. 19, 2005) ("The DCF model of valuation is a standard one that gives life to the finance principle that firms should be valued based on the expected value of their future cash flows, discounted to present value in a manner that accounts for risk.").

responsibly") (quoting *Orchard Enters.*, 2012 WL 2923305, at *17).[33] These inputs resulted in a WACC of 9.46%, which he then used throughout his analysis.

### d. Conversion to Equity Value

A DCF analysis reflects the value of cash flows that are available from the ongoing operations, including operating assets and operating liabilities. It does not reflect the value of the firm's non-operating assets and liabilities. JX896 ¶ 260 (Hubbard Report). Those must be added or subtracted as appropriate from the firm's enterprise value to derive the equity value. Hubbard appropriately accounted for these non-operating items in his valuation.

#### i. Excess Cash.

If a firm has more cash than is necessary for its operations, that excess cash must be added to the DCF valuation. *Id.* ¶¶ 261-63. Hubbard determined that Dell had $6.04 billion in excess cash on the merger date. *Id.* ¶ 263. He reached this conclusion by reviewing Dell's actual cash and investment amounts on Dell's balance sheet and then subtracting out cash required to support Dell's operations. *Id.*[34] The resulting $6.04 billion was then added to Hubbard's enterprise value.

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33 *See also* Pratt, *et al.*, *Cost of Capital: Applications and Examples*, at 79 ("For more than 30 years, financial theorists generally have favored the notion that using the [CAPM] is the preferred method to estimate the cost of equity capital.").

34 *See also* JX758 at DELLE00293277 (Dell Annual Report, Jan. 31, 2014) (reflecting actual cash at merger); JX623 at DELLE00381224 (Aug. 2013

JX907 ¶¶ 49-56 (Hubbard Rebuttal Report).

#### ii. Debt.

Just as excess cash must be added when converting enterprise value to equity value, so too must the company's debt be subtracted from enterprise value to arrive at equity value. JX896 ¶ 264 (Hubbard Report). Hubbard determined that Dell had $5.054 billion in debt on the merger date and subtracted that amount from its enterprise value. *Id.*

#### iii. FIN 48 Liability.

FIN 48 is a measurement of expected tax obligations related to past tax positions taken in various countries. Financial Accounting Standards Board, "FASB Interpretation No. 48: Accounting for Uncertainty in Income Taxes," *Financial Accounting Series*, June 2006, ("FASB Interpretation No. 48"), codified as FASB Accounting Standards Codification 740-10-55-3. It represents a non-operating liability that must be subtracted from enterprise value when converting to equity value. JX896 ¶ 265 (Hubbard Report). Dell's audited financial statements indicate that its FIN 48 liability on the merger date equaled $3.01 billion. *Id.* ¶ 267 & Ex. 22.

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Rating Agency Presentation) (noting that $5 billion required to run Dell's businesses); JX685 at DELLE00382674 (Sept. 3, 2013 Treasury Operations Report) ($5.17 billion required).

#### iv. U.S. Residual Tax on Foreign Earnings.

U.S. residual taxes on foreign earnings represent another non-operating liability that must be subtracted from enterprise value to convert to equity value. Dell's tax expert, Shay, determined from Dell's books and records that $6.3 billion of deferred taxes remained to be paid on profits earned overseas that had not been repatriated as of the merger date. JX922 ¶ 48 (Revised Shay Report). Another $5.4 billion of residual U.S. taxes would accrue on foreign earnings during the projection and transition period. JX896 at Ex. 23 (Hubbard Report).[35] Shay recommended that Hubbard "take the deferred taxes into account over a twenty-five year period beginning with the terminal date," which Hubbard did. JX922 ¶ 51 (Revised Shay Report); JX896 at Ex. 23 (Hubbard Report). The total U.S. residual taxes on foreign earnings on $11.7 billion was then present valued in Hubbard's model to arrive at a $2.2 billion reduction of equity value as of the merger date. JX896 at Ex. 23 (Hubbard Report).

### 2. Merger Price.

Combining all the inputs discussed above, Hubbard's DCF analysis produces a valuation of $12.68 per share as of the merger date. The credibility of his fair value calculation is reinforced by its proximity to the merger price. In light of the

[35] *See also* JX922 at Ex. 5 (Revised Shay Report). This amount represents the difference between the effective tax rate during the projection and transition periods and the marginal rate.

broad pre- and post-signing canvass of the market, the merger price is a "relevant factor" that should be considered in determining Dell's fair value. *Huff Fund Inv. P'ship v. CKx, Inc.*, 2013 WL 5878807, at *12 (Del. Ch. Nov. 1, 2013) ("The Court of Chancery has a statutory mandate to consider 'all relevant factors' in conducting an appraisal proceeding . . .").[36] The Court of Chancery has repeatedly held that a merger price "forged in the crucible of objective market reality . . . is viewed as strong evidence that the price is fair." *Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 467 n.12 (Del. Ch. 2011).[37]

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[36] *See also Highfields Capital, Ltd. v. AXA Fin. Inc.*, 939 A.2d 34, 60 (Del. Ch. 2007) ("[T]he court finds reasonable and appropriate [respondent's expert's] decision to grant the merger price great deference in his valuation analysis."); *Union Fin.*, 847 A.2d at 357 (holding that the Court should draw upon all "facts bearing on the market value of the subject company [which] includes the transaction that gives rise to the right of appraisal, so long as the process leading to the transaction is a reliable indicator of value and merger-specific value is excluded.").

[37] *See also LongPath Capital, LLC v. Ramtron Int'l Corp.*, 2015 WL 4540443, at *20 (Del. Ch. June 30, 2015) ("[I]n the situation of a proper transactional process . . . , this Court has looked to the merger price as evidence of fair value"); *Merlin P'rs LP v. AutoInfo, Inc.*, 2015 WL 2069417, at *14 (Del. Ch. Apr. 30, 2015) ("The Merger was the result of 'an adequate process.' The merger price is thus a strong indicator of value."); *In re Appraisal of Ancestry.com, Inc.*, 2015 WL 399726, at *24 (Del. Ch. Jan. 30, 2015) (noting that the merger price was "the best indicator of Ancestry's fair value as of the Merger Date"); *Rural Metro*, 88 A.3d at 102 ("Ordinarily this court places heavy reliance on the terms of a transaction . . . negotiated at arm's length, particularly if the transaction resulted from an effective pre—or post-agreement market canvas."); *CKx*, 2013 WL 5878807, at *1 ("It would be odd . . . if the sale were an arms-length, disinterested transaction after an adequate market canvas and auction, yet the challenge was that the price received did

The "objective market reality" in this case favors Dell. Dell was shopped to more than 70 strategic and financial investors, including many of the world's largest private equity funds in a process that Petitioners' experts concede was "robust" (JX909 ¶ 119 (Guhan Subramanian Rebuttal Report))[38] and that they do not and cannot fault in any respect (*see, e.g.*, Cornell Dep. at 25:23-26:6).[39]

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not represent 'fair' value."); *AXA Fin.*, 939 A.2d at 59 ("[A] court may derive fair value in a Delaware appraisal action if the sale of the company in question resulted from an arm's-length bargaining process where no structural impediments existed that might prevent a topping bid."); *Cede & Co. v. Technicolor, Inc.*, 2003 WL 23700218, at *44 (Del. Ch. Dec. 31, 2003, revised July 9, 2004) ("I use the Supreme Court's fairness opinion and the market value at the time of the merger, and the conduct of knowledgeable insiders, to check the reasonableness of my final valuation."); *M.P.M. Enters., Inc. v. Gilbert*, 731 A.2d 790, 797 (Del. 1999) (holding that a "merger price resulting from arms-length negotiations where there are no claims of collusion is a very strong indication of fair value"); *Union Fin.*, 847 A.2d at 357 ("[O]ur case law recognizes that when there is an open opportunity to buy a company, the resulting market price is reliable evidence of fair value."); *Van de Walle v. Unimation, Inc.*, 1991 WL 29303, at *17 (Del. Ch. Mar. 7, 1991) ("The most persuasive evidence of the fairness of the . . . merger price is that it was the result of arm's-length negotiations . . . , where the seller . . . was motivated to seek the highest available price, and a diligent and extensive canvass of the market had confirmed that no better price was available.").

38 *See also* Guhan Subramanian Deposition, Aug. 11, 2015 at 363:20-25 (App. Tab D) ("Q. You're not expressing any opinion that Evercore actually did anything other than the best it could to get a higher bid . . . ? A. Correct."); Bradford Cornell Deposition, Aug. 20, 2015 at 42:14-16 (App. Tab E) ("Q. . . . [Y]ou're not offering any opinion or criticism of Evercore's go-shop process? A. Correct.").

39 *See also* Cornell Dep. at at 34:20-23 ("Q. And as we discussed . . . , you don't intend to opine on the transaction process itself; correct? A. Correct."); *id.* at 40:23-41:2 ("Q. And . . . since you don't have an opinion on the process, you don't have any reason to believe it was not reasonable? . . . A. Correct.");

Despite this effort, and Dell's agreement to reimburse up to $25 million in due diligence expenses, nobody stepped forward to top Silver Lake. The smart, sophisticated and highly capitalized investors who participated in this process would not have dropped out if they thought Dell was worth more than $13.75 per share. More credibly, as reflected in the contemporaneous record at the time, knowledgeable investors such as KKR, TPG, and Blackstone passed on the opportunity because of the deteriorating PC market. JX481 (Dell Schedule 14A, Apr. 19, 2013); JX224 (Email from Alex Mandl, Dec. 4, 2012); JX532 at 30, 49-50 (5/30 Proxy). Hubbard properly considered these facts in reaching his conclusion that the merger price represents a valuation ceiling in this proceeding. JX896 ¶ 125 (Hubbard Report).[40]

### 3. Other Valuation Corroboration.

As additional confirmation for his valuation point estimate, Hubbard performed several corroborative checks. He first performed a DCF analysis using the Bank Case projections. JX896 ¶¶ 279-85 & Exs. 24-26 (Hubbard Report).

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Subramanian Dep. at 283:11-14 ("I'm not expressing an opinion about any individual bidder in the process, much less the subjective intent of that bidder in the process."); *id.* at 291:11-19, 326:5-7 ("I'm not saying what the Special Committee should have done.").

40 *See also Olson v. ev3, Inc.*, 2011 WL 704409, at *10 (Del. Ch. Feb. 21, 2011) ("In an arms-length, synergistic transaction, the deal price generally will exceed fair value because target fiduciaries bargain for a premium that includes both a share of the anticipated synergies and a portion of the reduced agency costs").

Hubbard used the same approach that he used with the BCG projections, but included an additional adjustment to account for stock-based compensation that Dell provided when public. *Id*. ¶¶ 280-81. Hubbard's Bank Case DCF results in a per-share valuation of $14.16, reasonably close to the actual merger price. *Id*. ¶ 284 & Figure 40.

Hubbard also considered a comparable companies analysis. *Id*. ¶¶ 286-88. He recognized that "the biggest challenge . . . is finding any truly comparable companies." *Id*. ¶ 289. After reviewing the data, Hubbard concluded that HP, though not a perfect match, was "the only company that is considered to be even approximately comparable to Dell on an overall company basis." *Id*. Applying HP's EV/EBITDA multiple to the 25% and Bank Cases produced a valuation range of $10.02-$11.27 per share, or somewhat below his point estimate of Dell's fair value on the merger date. *Id*. ¶ 298. Viewed holistically, Hubbard concluded that these additional market-based analyses corroborate his valuation of $12.68 per share.

### C. Petitioners' Valuation Is Not Reliable And Should Be Rejected.

Petitioners designated Bradford Cornell ("Cornell") as their valuation expert. Cornell states in his report that Dell's fair value as of the merger date was $28.89 per share. JX897 ¶ 18 (Report of Bradford Cornell, June 5, 2015 ("Cornell

Report")).[41] This valuation should be rejected because it is the product of unreliable and unreasonable assumptions and methods and is contradicted by market indicators such as the merger price.

### 1. Cornell's DCF Valuations Are Based on Misplaced Assumptions and Methodological Errors.

Cornell performed a DCF analysis based on three sets of projections: the 25% Case, the 75% Case and the Bank Case. His analysis diverges from Hubbard's analysis in four main areas: (i) projection period assumptions and adjustments; (ii) terminal period assumptions; (iii) discount rate; and (iv) enterprise to equity value conversion.

#### a. Projection Period Assumptions and Adjustments.

Cornell agrees that "the objective is to find the most reasonable and realistic set of projections for a company being valued as of the appraisal date." Cornell Dep. at 92:21-93:2. Notwithstanding this perspective, Cornell refuses to endorse the reasonableness of the projections that he used. *Id*. at 215:22-25 ("Q. . . . And you haven't made the determination as to the reasonableness of those projections, have you, sir? A. No."). Instead, he retreats to the position that if the Court believes those projections and adjustments, then the resulting output of his various

41 On September 28, 2015, Petitioners served revised versions of both reports previously submitted by Cornell. The revised reports contain slightly altered numbers, but these revisions do not affect the overall analysis in a material way.

DCF analyses is as indicated in his schedules. *Id*. at 211:6-15, 215:14-20. The problem is that there is no credible evidence to support the projections he uses or the adjustments he makes.

**i. Modified Bank Case Projections.**

Cornell apportions 50% of his valuation to a DCF based on a modified Bank Case. JX897 ¶ 91 (Cornell Report). Hubbard uses the Bank Case for corroboration of his primary valuation so the main dispute concerns Cornell's modifications to the projections.

By far, the most significant modification Cornell made to the Bank Case was his addition of $1 billion in free cash flow to Dell's bottom line *in perpetuity* based on an assumption that Dell will achieve 100% of contemplated cost savings and that all such savings will fall to the bottom line. Cornell Dep. at 116:17-20. Cornell did not make any assessment of whether Dell had plans in place or commitments to achieve such savings. *Id*. at 70:19-25, 116:11-20. When pressed for evidence to support his assumptions, Cornell could not identify any. *Id.* at 71:2-11. When confronted with actual, contemporaneous evidence concerning Dell's prior cost savings initiatives, Cornell retreated to the view that his role was limited to providing mathematical calculations based on assumed projections. *Id*. at 113:21-114:5, 119:3-12, 126:15-19.

Cornell's extreme valuation is the product of his failure to engage in a critical examination of Dell's cost savings program. Having never reviewed Dell's prior $4 billion cost savings program, Cornell could not identify any market impact or cost savings from that program that actually fell to the bottom line. *Id*. at 123:9-19, 124:11-16. His analysis simply ignores the realities of the highly competitive, dynamic markets in which Dell operates and the need to reinvest savings to stay competitive. And, although Dell's latest cost savings program was publicly disclosed and widely discussed (JX907 at Rebuttal Appendix C (Hubbard Rebuttal Report)), Cornell never undertook an economic analysis or event study to quantify the impact of that information on Dell's value (Cornell Dep. at 65:12-24). Had he done so, he would have seen that Dell's stock price increased only $0.29 following announcement of the program. JX907 ¶ 80 (Hubbard Rebuttal Report). Because Cornell performed no independent analysis regarding cost savings, he could only speculate as to why the market did not believe savings would fall to the bottom line as the following exchange from his deposition illustrates.

> Q. . . . And if you assume that the cost savings initiatives were made known to the bidders in the go-shop, why . . . would . . . bidders . . . leave $26 billion on the table?
>
> A. Well, they wouldn't believe they were leaving $26 billion on the table. I mean, they may conclude that we have seen Dell do this before. We have seen them say they are going to transform themselves. We have seen them say that they are going to achieve cost savings, you know, this may be a New York Jets. The Jets keep saying

> they are about ready to turn around and, you know, it hasn't happened. So they could be skeptical.

Cornel Dep. at 125:15-126:4; *see also id.* at 66:1-11.

In contrast to Cornell's indifference to the details surrounding Dell's cost savings initiatives, Hubbard took the time to understand the impact of those programs on Dell's bottom line. JX907 ¶¶ 68-84 (Hubbard Rebuttal Report). He reviewed prior programs and their impact on operating income. *Id*. ¶¶ 69-72. He reviewed public statements and contemporaneous documents about Dell's programs which confirmed that *from the outset* management planned to reinvest savings in the business and in addressing market competiveness issues, including pricing. *Id*. ¶¶ 77-78; *see also* JX569 at DELLE00422650 (SC Presentation); JX807 at DELLE00216716 (Apr. 2014 Rating Agency Presentation). Those statements and documents were consistent with the testimony of Dell's current CFO, Tom Sweet:

> [M]ost of our cost savings, if not all, are reinvested back into the business in forms of either pricing aggressiveness, to put us in the right price position, or to fund investments into the business or into the capabilities of business vis-à-vis improving our infrastructure, and therefore, most, if not all, . . . of the costs identified and taken up through the productivity programs will not show up in the operating income of the company.

Tom Sweet Deposition, Aug. 25, 2015 at 301:7-22 (App. Tab F).

In sum, Hubbard looked beyond bare assumptions to assess whether the modified Bank Case put forth by Cornell was realistic and reasonably achievable. Based on the actual evidence, he concluded it was not.

**ii. The 25% Case.**

Cornell apportions 25% of his valuation to a DCF based on the 25% Case. JX897 ¶ 18 (Cornell Report). Hubbard also uses those projections in his own DCF analysis, but used the most recent IDC numbers for PCs to reflect the operating reality on the merger date. JX896 ¶¶ 192-94 (Hubbard Report); JX907 ¶¶ 42-43 (Hubbard Rebuttal Report). Cornell does not dispute that the market deteriorated during 2013 or that the August 2013 IDC forecasts were the most recent forecasts at the time of the merger. Cornell Dep. at 102:4-11, 105:5-14. He also does not assert that updating the forecasts to reflect the most recent data is somehow inappropriate. Rather, he testified that this "would be another decision in which [he] would defer to the company and its advisers." *Id*. at 101:7-13. Had he examined the more recent data, he would have seen that this data demonstrates that his projections were not realistic or reasonably achievable.

**iii. The 75% Case.**

Cornell apportions 25% of his valuation to a DCF based on the 75% Case. JX897 ¶ 18 (Cornell Report). Cornell did not conclude that these projections were as plausible as the 25% Case to which he ascribed equal weight, but instead conceded that it was the "only way [he] could get to a 50% case" that he wanted to use for his calculations. Cornell Dep. at 77:18-20, 98:10-23, 112:9-12. These projections imply an additional $1.6 billion in cost savings falling to the bottom line over those already incorporated into the Base Case and 25% Case. Cornell's use of these projections is not tethered to Dell's operative reality or the actual evidence. *Id*. at 99:6-12 ("Q. So it's . . . fair to say, isn't it, Professor . . . that it doesn't really matter to your 50 percent case, per se, what the special committee or [its] advisers thought was the likelihood of the 25 percent case or the 75 percent case? A. I think that's fair, yes.").

In fact, a J.P. Morgan presentation given shortly before the merger noted: "Given aggressive margin expansion assumptions, the BCG 75% Case was deemed by the Special Committee to be aspirational at best." JX621 at JPM_0163112 (July 31, 2013 J.P. Morgan Preliminary Analysis).[42] The Proxy also disclosed that the Committee had "doubt as to whether the productivity cost reductions reflected in the BCG 75% Case . . . [we]re realistically achievable" because "only some of those cost reductions ha[d] been specifically identified by the Company's management and . . . J.P. Morgan's analysis indicated that the [assumed] cost reductions . . .

[42] *See also* JX896 ¶¶ 172-75 (Hubbard Report); JX907 ¶¶ 57-64 (Hubbard Rebuttal Report); Alex Mandl Deposition, Apr. 2, 2015 at 139:8-24, 150:13-21 (App. Tab G); Drago Rajkovic Deposition, Apr. 15, 2015 at 223:19-224:7 (App. Tab H).

would imply margins in fiscal year 2016 . . . . higher than those ever achieved by the Company or its principal competitors." JX532 at 52-53 (5/30 Proxy). Equally telling, no bidder thought the 75% Case was credible, as reflected by the absence of any topping bid. The 75% Case was aspirational and not a proper basis for valuing Dell as of the merger date.

**b. Terminal Period Cash Flow Projections.**

For the post-projection period, Cornell used a two-stage DCF model, a 1% perpetuity growth rate and a terminal tax rate of 21%. JX897 ¶¶ 100, 105 (Cornell Report). While Hubbard submits that a three-stage DCF model is more appropriate for the reasons set forth in his report (JX896 ¶¶ 200-02 (Hubbard Report); *see also PFPC Worldwide*, 2005 WL 2045640, at *12 ("neither approach is inherently preferable")), the two far more significant errors in this area concern Cornell's use of an inappropriate terminal tax rate and his failure to include investment to support the terminal growth he envisions. These two errors significantly inflate his valuation. JX907 ¶¶ 31-41 (Hubbard Rebuttal Report) (BCG Case); *id.* ¶¶ 86-87 (Bank Case).

**i. Terminal Tax Rate.**

Cornell models a 21% tax rate during the terminal period. He concedes that he is not a tax expert and that he did not perform any analysis on the appropriate tax rate for Dell in the terminal period or any other period. Cornell Dep. at 15:16-

18 ("Q. . . . And you're not a tax expert; is that correct? A. Correct."); *id.* at 157:13-14; 140:5-8 ("Q. But you didn't make an independent decision that 21 percent was an appropriate terminal tax rate; is that correct? A. Correct.").[43] Petitioners' tax expert, Steines, similarly disavowed any opinion on the appropriate terminal tax rate. John Steines Deposition, July 30, 2015 at 41:3-16, 49:20-50:8, 53:4-54:5, 58:17-21 (App. Tab I). Neither researched the law or finance literature on the appropriate terminal tax rate. Had they done so, they would have seen that modeling a 21% tax rate in the terminal period is incorrect. Indeed, in the recent *Ancestry.com* appraisal case, the Court observed:

> [I]t strikes me as overly speculative to apply the current tax rate in perpetuity. I agree with this Court's approach in *Henke v. Trilithic Inc.* to ***use the marginal tax rate*** [b]ecause of the transitory nature of tax deductions and credits.

*In re Appraisal of Ancestry.com, Inc.*, 2015 WL 399726, at *20 (emphasis added) (quoting *Henke v. Trilithic Inc.*, 2005 WL 2899677, at *9 (Del. Ch. Oct. 28, 2005)).

The academic and finance literature further explains the reasoning for this sound principle:

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[43] *See also id.* at 28:11-14 ("Q. So to the extent there are opinions to be given on those underlying tax issues, you don't plan on giving them; is that correct? A. Yes.") The 21% tax rate used by Professor Cornell did not come from Petitioners' expert John Steines. *Id.* at 140:9-12.

> [I]t is ***always the marginal tax rate that has to be used*** since all deferred tax assets get neutralized over a period of time and the company will eventually pay tax at the marginal rate.[44]
>
> * * *
>
> In valuing a firm, should you use the marginal or the effective tax rates? If the same tax rate has to be applied to earnings every period, the safer choice is the marginal tax rate because none of the reasons noted above can be sustained in perpetuity. As new capital expenditures taper off, the difference between reported and tax income will narrow; tax credits are seldom perpetual; and firms eventually do have to pay their deferred taxes. There is no reason, however, why the tax rates used to compute the after-tax cash flows cannot change over time. Thus, in valuing a firm with an effective tax rate of 24% in the current period and a marginal tax rate of 35%, you can estimate the first year's cash flows using the effective tax rate of 24% and then increase the tax rate to 35% over time. It is ***good practice to assume that the tax rate used in perpetuity to compute the terminal value be the marginal tax rate***.[45]
>
> * * *
>
> [I]t is ***critical to use the marginal rate in calculating after-tax operating income in perpetuity***. Otherwise, the implicit assumption is that taxes can be deferred indefinitely.[46]
>
> * * *
>
> The marginal tax rate used to determine the after-tax cost of debt must match the ***marginal tax rate used to determine free cash flow***.[47]

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44 Pratap Giri Subramanyam, *Investment Banking: Concepts, Analysis and Cases*, at 218 (emphasis added).

45 JX73 at 252 (Damodaran, *Investment Valuation*) (emphasis added).

46 JX751 at 229-30 (DePamphilis, *Mergers, Acquisitions, and Other Restructuring Activities*) (emphasis added).

47 Koller, *et. al*, *Valuation*, at 234 (emphasis added).

Cornell's uninformed decision to apply the wrong tax rate to the terminal period significantly inflates his valuation.

### ii. Investment to Support Growth.

Cornell also inflates his valuation through an inconsistent approach to modeling investment to support growth in the terminal period. Cornell agrees with Hubbard that, as a matter of basic finance, growth requires investment. JX896 ¶ 206 (Hubbard Report); JX907 ¶¶ 33-41 (Hubbard Rebuttal Report).[48] Notwithstanding this agreement, Cornell does not include any investment in the terminal period to support the growth he models in his BCG Case valuations. In addition, although acknowledging the general principle that a higher perpetuity growth rate will require a higher level of investment, he did not include any such calculations in his rebuttal of Hubbard's valuation. JX907 ¶¶ 33-41 (Hubbard Rebuttal Report); Cornell Dep. at 170:18-171:9. Instead, Cornell assumed a world in which Dell can grow indefinitely without investing, resulting in an ever-increasing return on invested capital despite the absence of a sustainable competitive advantage. JX907 ¶ 41 (Hubbard Rebuttal Report).

48 *See also* Cornell Dep. at 161:22-24 ("Q. Do you agree that growth requires investment? A. Yes.").

#### c. Discount Rate.

Cornell uses a discount rate of 9.00%. This rate is lower than the rates calculated by Hubbard and the professionals who evaluated Dell around the time of the merger. JX896 ¶ 257 (Hubbard Report).[49] This divergence is driven almost entirely by Cornell's use of an abnormally low equity-risk premium. JX896 ¶¶ 226-57 (Hubbard Report); JX907 ¶¶ 22-28 (Hubbard Rebuttal Report); JX897 ¶¶ 101-11 (Cornell Report); JX908 ¶¶ 80-84 (Bradford Cornell Rebuttal Report, dated July 24, 2015 ("Cornell Rebuttal Report")).

| | **Cornell** | **Hubbard** |
|---|---|---|
| Capital Structure | 75.25% | 74.75% |
| Cost of Equity | | |
| Risk-Free Rate | 3.31% | 3.31% |
| Beta | 1.35 | 1.31 |
| Equity Risk Premium | 5.50% | 6.41% |
| Cost of Debt | | |
| Debt Yield | 4.95% | 4.45% |
| Tax Rate | 21.0% | 35.8% |
| **WACC** | **9.03%** | **9.46%** |

49 *See also* Ibbotson, *2013 Cost of Capital Yearbook* (SIC 357) (industry WACC 9.65-10.36%); JX654 at 34 (8/14 Proxy) (WACC 8.5-11.0%); *id*. at 45 (WACC 10.0-12.0%); JX722 at DELLE00730659 (Houlihan Lokey Discussion Materials, Oct. 22, 2013) (WACC 9.0-11.0%); JX270 at "DCF" sheet (Jan. 9, 2013 Morgan Stanley DCF Model) (WACC 9.6%); JX275 at "DCF" sheet (Jan. 9, 2013 Citi Investment Research DCF Model) (WACC 10.1%).

Hubbard averaged the historical and supply side equity risk premiums from the relevant Ibbotson Valuation Yearbook to obtain his equity risk premium. JX896 ¶¶ 246-50 (Hubbard Report); JX907 ¶¶ 23-25 (Hubbard Rebuttal Report).[50] In doing so, he acknowledged the ongoing debate within the finance community as to the equity risk premium. JX896 ¶ 249 (Hubbard Report). In contrast, Cornell ignored the risk premiums in the Ibbotson Yearbook and, instead, selected an "idiosyncratic" equity risk premium for which "there's nothing you can point to to foot it." Cornell Dep. at 197:13-18, 198:23-25. As a result, he admits that "it may be hard for Vice Chancellor Laster or anyone else to come to grips with it . . . ." *Id*. at 200:7-11. Cornell's unorthodox approach leads to a lower discount rate and an overvaluation of Dell. His departure from Court precedent and standard valuation methodology is unreliable, cannot be replicated and should be rejected.

**d. Enterprise to Equity Value Conversion.**

Cornell's failure to properly account for non-operating assets and liabilities overstates his valuation by more than $6 per share. JX907 ¶¶ 49-56 (Hubbard Rebuttal Report).

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[50] Cornell agrees that the proper figures from the Ibbotson tables are 6.70% (historical) and 6.11% (supply). Cornell Dep. at 196:3-24.

#### i. Excess Cash.

Cornell made two fundamental errors in his calculation of Dell's excess cash as of the merger date.

*First*, rather than use the actual cash on the merger date reflected on Dell's audited financial statements (as Hubbard did), Cornell substituted the cash figures from a mid-September estimate prepared by Silver Lake of Dell's expected closing cash balances. JX908 ¶ 66 (Cornell Rebuttal Report).[51] He also improperly included $238 million in investments on the balance sheet set aside for pension and retirement obligations. JX907 ¶ 50 (Hubbard Rebuttal Report).[52]

*Second*, Cornell assumed without any analysis that Dell did not require any cash to support its operations. JX907 ¶ 51 (Hubbard Rebuttal Report); Cornell Dep. at 175:18-176:2, 176:15-19. As a result, he "treated all cash as excess" cash in his DCF model. In doing so, Cornell ignored contemporary records to posit a world that does not reflect Dell's operative reality. Indeed, as Hubbard discussed in his reports, Dell required approximately $5 billion to fund its ongoing operations. JX896 ¶¶ 261-63 (Hubbard Report); JX907 ¶¶ 51-52 (Hubbard Rebuttal Report); Sweet Dep. at 246:2-14.

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51 *See also* Cornell Dep. at 172:7-9 ("Q. . . You based your numbers off the September 13 Silver Lake preliminary estimate; is that correct? A. Yes.").

52 *See also* Cornell Dep. at 173:9-11 ("If it's something that's truly not available to the shareholders, it should not be added to the cash").

### ii. Debt.

As with cash, rather than use Dell's actual debt balances from its audited financial statements, Cornell used a mid-September estimate of Dell's closing debt prepared by Silver Lake. JX896 ¶ 264 (Hubbard Report); JX907 ¶ 50 (Hubbard Rebuttal Report).

### iii. FIN 48 Liability.

Despite agreeing with Hubbard that "a company's non-operating liabilities should be subtracted from its DCF value to the extent they reflect additional cash outlays that are not reflected in the DCF analysis" (JX908 ¶ 68 (Cornell Rebuttal Report)), Cornell inexplicably failed to subtract $3.01 billion from his enterprise value to account for Dell's best judgment with respect to future tax liability that is recorded in its audited financial statements as its FIN 48 liability. When questioned about this omission, Cornell demurred and stated that he assumed that "the effective tax rate incorporated all the tax effects, and that would include FIN 48." Cornell Dep. at 186:21-187:8. When pressed further to explain how a potential liability for past-tax positions was reflected in a prospective operating tax rate (which he admits that he did not even attempt to calculate), Cornell finally conceded: "That's the assumption I am making. If it's incorrect, then it would have to be updated or altered." *Id*. at 187:9-17.

Cornell also deferred to Steines on this issue, even though Steines never mentioned FIN 48 in his report and stated that he was not asked to provide any such opinion and would not be testifying on that issue at trial. *Id*.[53] Cornell's reliance on Steines for an opinion the latter is not rendering demonstrates the lack of support for Cornell's position. The inclusion of such an obvious error in Cornell's calculations overstates his valuation of Dell by $1.71 per share. JX907 ¶ 54 (Hubbard Rebuttal Report).

#### iv. U.S. Residual Taxes on Foreign Earnings.

Cornell also did not take into account $6.3 billion in deferred taxes reflected on Dell's financial statements. Cornell does not account for additional U.S. residual taxes that will arise in connection with future earnings that he assumes will be taxed at 21%. Instead, he essentially assumed that deferral strategies would continue indefinitely and render these future taxes meaningless (he makes no similar assumption when valuing the overseas cash and added it to his enterprise value). JX908 ¶ 74 (Cornell Rebuttal Report); Cornell Dep. at 144:22-145:4. In doing so, Cornell assumed the continued existence of foreign tax holidays even though Dell's SEC disclosures plainly provide: "Our significant tax holidays expire in whole or in part during Fiscal 2016 through Fiscal 2022." JX404 at 47

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[53] *See also* Steines Dep. at 26:9-15 (Q. You weren't asked to opine on FIN 48, were you? A. I was not. Q. So you won't be testifying about that at trial; is that right? A. Not to my knowledge. I have not been asked to do that.").

(Dell FY2013 10-K); *see also* Sweet Dep. at 45:2-8. For his part, Steines agrees with Shay that Dell cannot defer taxes indefinitely, but made no attempt to calculate the residual tax that Dell will incur if it repatriates its foreign earnings. Steines Dep. at 55:18-25, 85:10-18, 140:11-14, 165:25-166:15, 194:13-195:5. This error overstates Cornell's valuation by $1.25 per share. JX896 ¶¶ 268-71 (Hubbard Report); JX907 ¶ 55 (Hubbard Rebuttal Report).

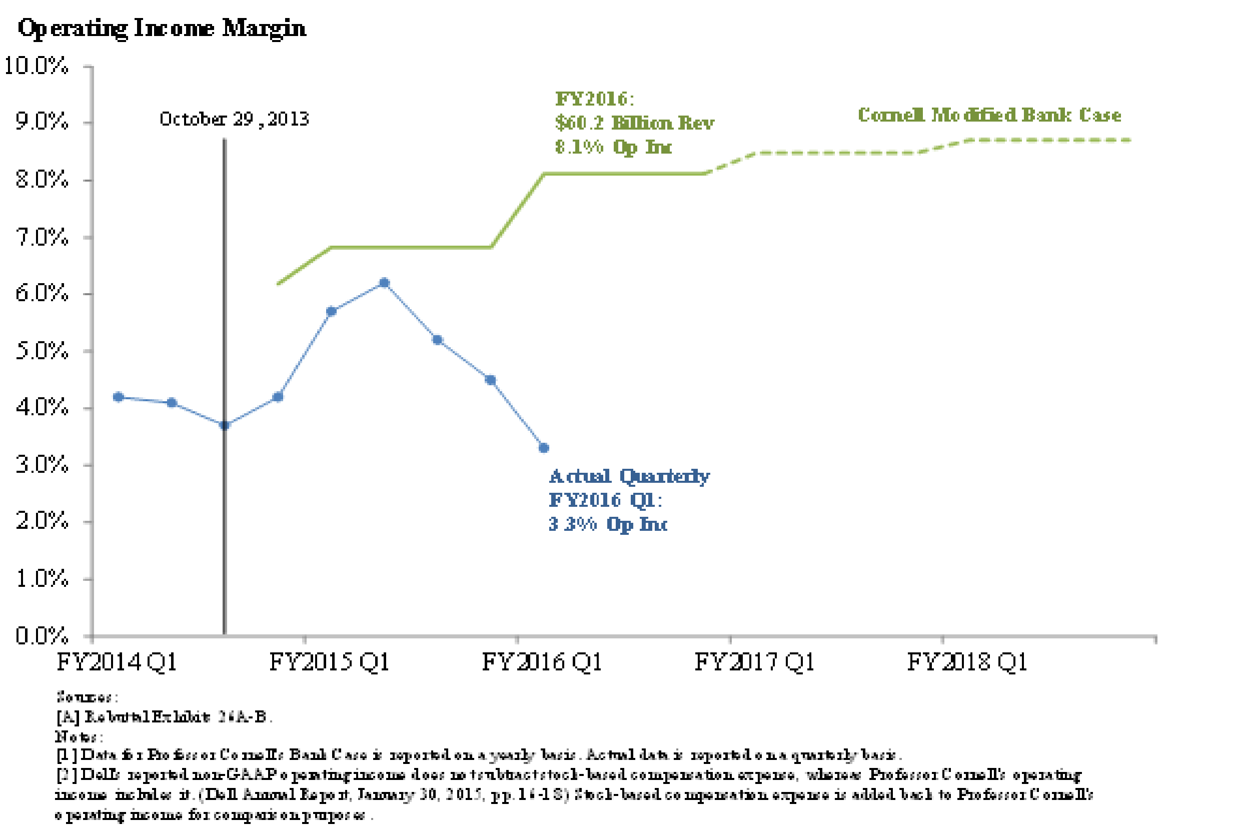
**2. Other Analyses.**

In an attempt to bolster his opinion, Cornell purported to test his conclusion by performing several sensitivity analyses, none of which is accorded any weight in his ultimate valuation. Cornell undermined the usefulness of that exercise, however, by applying the same faulty assumptions and same methodological errors that led to his initial valuation overstatement. JX907 ¶¶ 98-125 (Hubbard Rebuttal Report). Moreover, in shifting to a relative approach, Cornell introduces error and uncertainty through a subjective selection of comparable companies – a deficiency exacerbated when he attempted to apply multiples from those companies to segment projections without adjusting the underlying projections for dis-synergies and proper allocation of corporate overhead. *Id*. ¶¶ 102-25.

More importantly, these collateral analyses still do not answer the basic question presented by Cornell's valuation: how did the world's most sophisticated private equity firms that reviewed this transaction somehow miss more than $26 billion in value? One explanation offered by Cornell for the huge divergence between his valuation and the merger price was "that the market and potential bidders did not believe the reasonableness of [his] assumptions." Cornell Dep. at 211:16-21. Another explanation is suggested by his own writings: "a market that is not perfectly efficient may still value securities more accurately than appraisers who are forced to work with limited information and whose judgments by nature reflect their own views and biases." Bradford Cornell, *Corporate Valuation*, at 46 (1993). Either way, Cornell did not heed his own caution that "appraisers should not substitute their own judgment for that of the market." *Id*. at 47.

Finally, although Cornell trumpeted Dell's post-merger performance in his opening report, Petitioners now appear to have reversed course and run from that performance.[54] The following chart makes clear why: Dell's performance has fallen far short of what Cornell modeled. JX907 ¶¶147-49 & Fig. 20 (Hubbard Rebuttal Report).

[54] Petitioners had access to Dell's post-merger financial performance through their investment in Dell's debt securities. JX907 ¶ 148 & n.228 (Hubbard Rebuttal Report).




In other words, the actual real world performance of Dell after the merger further confirms that Cornell's valuation is grounded on projections that were not reasonable or realistically achievable. When coupled with his other misplaced assumptions and methodological errors, it becomes clear how Cornell arrived at his extreme valuation.

## CONCLUSION

For the foregoing reasons, Dell respectfully requests that the Court (i) dismiss with prejudice appraisal claims as to all shares voted in favor of the merger; (ii) enter judgment determining that the fair value of Dell as of October 29, 2013, was $12.68 per share; and (iii) award Dell further relief that the Court deems just and appropriate.

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**CERTIFICATE OF SERVICE**

I hereby certify that, on the 5th day of October, 2015, true and correct copies of the foregoing were caused to be served on counsel of record at the following address as indicated:

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