



CERTIFICATE OF SERVICE

I, Christine M. Mackintosh, hereby certify that on October 7, 2015, the
Public Un-Redacted Version of Petitioners' Pre-Trial Brief was filed and served
via File & ServeXpress on the following counsel of record:

Jeremy D. Anderson
FISH & RICHARDSON P.C.
222 Delaware Avenue
17th Floor
Wilmington, DE. 19801

Thomas A. Uebler
COOCH & TAYLOR, P.A.
The Brandywine Building
1000 West Street, 10th Floor
Wilmington, DE 19801

John D. Hendershot
Gregory P. Williams
Susan M. Hannigan
Andrew Peach
RICHARDS LAYTON & FINGER
One Rodney Square
920 North King Street
Wilmington, DE 19801

Samuel T. Hirzel, II
Melissa N. Donimirski
PROCTOR HEYMAN ENERIO LLP
300 Delaware Avenue, Suite 200
Wilmington, DE 19807

/s/ Christine M. Mackintosh
Christine M. Mackintosh (#5085)



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN RE: APPRAISAL OF DELL INC.

Consol. C. A. No. 9322-VCL

**PUBLIC VERSION TO BE
FILED OCTOBER 5, 2015**

PETITIONERS' PRE-TRIAL BRIEF

GRANT & EISENHOFER P.A.

Stuart M. Grant (# 2526)
Michael J. Barry (# 4368)
Christine M. Mackintosh (# 5085)
123 Justison Street
Wilmington, DE 19801
(302) 622-7000

Counsel for Petitioners

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	iii
BACKGROUND OF THE TRANSACTION	1
ARGUMENT	12
I. ISSUES REGARDING THE DISCOUNTED CASH FLOW VALUATION OF DELL	14
A. Professor Cornell Appropriately Considered The BCG 25% And 75% Cases And The Bank Case.....	14
1. The BCG Cases And The Cost Savings Overlay.....	14
2. The Bank Case	22
3. Professor Cornell Appropriately Weighted The BCG Forecasts And the Bank Case Forecast	25
B. The BCG Forecasts Do Not Have To Be “Revised”	28
1. The BCG Forecasts Did Not Have To Be Revised Downward To Reflect A Decline In PC Sales.....	28
2. Professor Hubbard’s “Transition Period” Is Inappropriate	32
C. HUBBARD ARTIFICIALLY RAISED DELL’S TAX RATE IN THE TERMINAL PERIOD TO DRAMATICALLY LOWER DELL’S VALUE	35
II. THE PROPER ADJUSTMENTS FOR EXCESS CASH TO THE DCF VALUATION OF DELL	40

A.	Because The Forecasts Already Model Working Capital To Be Funded From Operations, It Is Unnecessary And Inappropriate To Deduct Working Capital Requirements From Dell’s Cash Balance At Closing	41
B.	Professor Hubbard Creates Certain Tax Adjustments To Lower Dell’s Value	44
1.	The Idea That Dell Will Repatriate All Of Its Overseas Cash At a 35.8% Tax Rate Beginning In 2023 Is Fantasy	46
2.	Using The FIN 48 Accounting Convention To Reduce The Value Of Dell Is Improper And Unprecedented.	50
III.	OTHER DIFFERENCES	53
A.	Terminal Growth Rate.....	53
B.	WACC	56
IV.	THE MARKET PRICE IS NOT A TRUE MEASURE OF DELL’S FAIR VALUE; THIS FACT IS NOT CHANGED BY THE GO-SHOP PROCESS	58
A.	Dell’s Management Recognized That The Company Was Undervalued	60
B.	The Lack Of A Topping Bid Does Not Militate In Favor Of Deferring To The Deal Price.....	62
	CONCLUSION	65

TABLE OF AUTHORITIES

Page(s)

Cases

<i>Andaloro v. PFPC Worldwide, Inc.</i> , 2005 WL 1045640 (Del. Ch. Aug. 19, 2005)	33
<i>In re Appraisal of Ancestry.com</i> , 2014 WL 3752941 (Del. Ch. June 18, 2014).....	39
<i>In re Appraisal of Ancestry.com</i> , 2015 WL 399726 (Del. Ch. Jan. 30, 2015).....	39
<i>In re AT&T Mobility Wireless Operations Holdings Appraisal Litig.</i> , 2013 WL 3865099 (Del. Ch. June 24, 2013).....	38
<i>Cede & Co. v. JRC Acquisition Corp.</i> , 2004 WL 286963 (Del. Ch. Feb. 10, 2004).....	38
<i>Crescent/Mach I Partnership, L.P. v. Turner</i> , 2007 WL 1342263 (Del. Ch. May 2, 2007).....	38
<i>Delaware Open MRI Radiology Assocs. v. Kessler</i> , 898 A.2d 290 (Del. Ch. 2006)	22, 38
<i>In re Dole Food Co., Inc. S'holder Litig.</i> , 2015 WL 5052214 (Del. Ch. Aug. 27, 2015)	24
<i>Global GT LP v. Golden Telecom, Inc.</i> , 993 A.2d 497 (Del. Ch. 2010), <i>aff'd</i> 11 A.3d 214 (Del. 2010)	38, 53
<i>Golden Telecom, Inc. v. Global GT LP</i> , 11 A.3d 214 (Del. 2010)	11, 12, 58, 59
<i>Gray v. Cytokine Pharmasciences, Inc.</i> , 2002 WL 853549 (Del Ch. Apr. 25, 2002).....	38

<i>Highfields Capital, Ltd. v. AXA Fin., Inc.</i> , 939 A.2d 34 (Del. Ch. 2007)	12
<i>M.P.M. Enters., Inc. v. Gilbert</i> , 731 A.2d 790 (Del. 1999)	11
<i>Merion Capital L.P. v. 3M Cogent Inc.</i> , 2013 WL 3793896 (Del. Ch. July 8, 2013)	29, 33
<i>Ng v. Heng Sang Realty Corp.</i> , 2004 WL 885590 (Del. Ch. Apr. 22, 2004), <i>aff'd</i> 867 A.2d 901 (Del. 2005)	38, 46
<i>In re Orchard Enters., Inc.</i> , 2012 WL 2923305 (Del. Ch. July 18, 2012)	27, 59
<i>Owen v. Cannon</i> , 2015 WL 3819204 (Del. Ch. June 17, 2015).....	23, 38
<i>Paskill Corp. v. Alcoma Corp.</i> , 747 A.2d 549 (Del. 2000)	49, 50
<i>Prescott Grp. Small Cap, L.P. v. Coleman Co.</i> , 2004 WL 2059515 (Del. Ch. Sept. 8, 2004).....	54
Other Authorities	
Financial Accounting Standard Board FASB Interpretation No. 48 “Accounting for Uncertainty in Income Taxes.”	45

GLOSSARY

Bank Case	Set of projections of Dell prepared by Silver Lake in January 2013, as modified in August 2013 and as presented to investors in September 2013
Bank Case With Cost Savings	Bank Case with impact of \$1 billion in incremental cost savings as identified by Silver Lake
BCG	The Boston Consulting Group, Inc.
CAGR	Compound annual growth rate
Company	Dell Inc.
DCF	Discounted cash flow
Dell	Dell Inc.
EBITA	Earnings before interest, taxes, and amortization
EBITDA	Earnings before interest, taxes, depreciation and amortization
EUC	End-user computing
Evercore	Evercore Group LLC
ESS	Enterprise solution and services
FY	Fiscal Year
Gartner	Gartner, Inc.
HP	Hewlett-Packard Company

IDC	International Data Corporation
KKR	Kohlberg Kravis Roberts & Co. L.P.
LBO	Leveraged buyout
Merger Agreement	The Agreement and Plan of Merger by and among Denali Holding Inc., Denali Intermediate Inc., Denali Acquiror Inc., and Dell Inc., dated February 5, 2013 (as amended on August 2, 2013)
MoM	Multiple of invested capital
PC	Personal computer
PGR	Perpetuity growth rate
PTO	Stipulated [Proposed] Joint Pre-Trial Order (Transaction ID 57892025)
ROIC	Return on invested capital
S&D	Support and deployment
Silver Lake	Silver Lake Management LLC
Southeastern	Southeastern Asset Management
Transaction	Transaction in which Michael Dell took Dell private with two funds affiliated with Silver Lake, as effected through the Merger Agreement
WACC	Weighted average cost of capital

CITATION CONVENTIONS

Deposition of Michael Dell:	“Dell __”
Deposition of Egon Durban:	“Durban __”
Deposition of Brian Gladden:	“Gladden __”
Deposition of Glenn Hubbard:	“Hubbard __”
Deposition of Alex Mandl:	“Mandl __”
Deposition of Ron Nicol:	“Nicol __”
Deposition of Lutao Ning:	“Ning __”
Deposition of Drago Rajkovic:	“Rajkovic __”
Deposition of Stephen Shay:	“Shay __”
Deposition of Thomas Sweet:	“Sweet __”
Expert Report of Glenn Hubbard:	“Hubbard Rpt. __”
Expert Rebuttal Report of Glenn Hubbard:	“Hubbard Reb. __”
Expert Report of Stephen Shay:	“Shay Rpt. __”
Expert Rebuttal Report of Stephen Shay:	“Shay Reb. __”
Expert Rebuttal Report of John Steines:	“Steines Rpt. __”
Expert Rebuttal Report of Guhan Subramanian	“Subramanian Rpt. _”
Revised Expert Report of Brad Cornell:	“Cornell Rpt. __”

Revised Expert Rebuttal Report of Brad Cornell: “Cornell Reb. __”

Joint Exhibit: “JX__”

BACKGROUND OF THE TRANSACTION

Beginning in 2009, Dell embarked on a strategy to transform itself from an EUC business (*i.e.*, a company that makes and sells PCs) into an ESS business (*i.e.*, a company that provides information technology solutions to large and medium-size businesses).¹ Dell did this because the global PC market was experiencing pressure as computer users adopted new technologies like smartphones and tablets.² Dell's core PC business was impacted by these new technologies, and founder and long-time CEO Michael Dell recognized that he needed to revamp his Company if it wished to remain competitive.³ Dell planned to transform its business so that the ESS operations would make up a larger portion of Company's overall operations, making Dell less reliant on PC sales.⁴ The transformation necessarily was a long-term plan⁵ and was anticipated to take several years to complete.⁶

¹ PTO ¶88; JX 670 at DELLE00779558 (“In FY 2009, Dell reset its strategy to transform itself from a PC/server vendor into a leading provider of end-to-end enterprise IT solutions.”); Mandl 16:23-17:1; Rajkovic 24:19-7.

² Mandl 16:13-22.

³ Dell 101:15-102:12.

⁴ Mandl 19:24-20:11; Dell 126:13-127:6; JX532 at 17.

⁵ JX670 at DELLE00779558.

⁶ PTO ¶89; JX532 at 31 (as of December 2012 Dell CFO Brian Gladden believed that “fully implementing the plan would require another three to five years”); Mandl 18:20-19:11 (anticipating transformation would take 4-5 years from 2009).

In the years leading up to the Transaction, Michael Dell and his team managed the Company with an eye towards long-term value. To this end, Dell took actions that it knew might hurt the Company's short-term stock performance.⁷ Dell spent approximately \$14 billion between 2009 and 2012 to acquire other technology-related businesses necessary for its transformative strategy.⁸ Dell expected that these acquisitions eventually would earn the Company a substantial return, and would enable the Company to flourish as an ESS provider.⁹ However, the market's failure to value the transformation, in conjunction with Dell's long-term-oriented investment and pricing decisions, caused Dell's stock to trade at a substantial discount to the Company's true value.¹⁰

⁷ Dell 276:11-277:24 (policy and strategy to sacrifice short-term margin for long-term share growth); JX515 at DELLE0038567 ("Dell's weak gross margin performance is attributable to a continued deliberate attempt to sacrifice margins for market share"); JX96 at DELLE00629549 (Company was "committed to accelerating transformation and shifting mix over time ... will sacrifice short term results").

⁸ JX669 at DELLE00779558 ("Significant progress has been made in executing the transformation ... \$14B in acquisition spend has created an expansive enterprise solutions and services business (\$21B in FY13 revenue) that benefits from favorable industry growth outlook 4-5% '13-17E CAGR) and drives revenue visibility and margin expansion"); Mandl 19:13-15.

⁹ Mandl 19:13-23.

¹⁰ JX97 at DELL00017558.

The Company, and Michael Dell in particular, did not share the market's pessimism. While Dell recognized that the PC business was becoming increasingly competitive and expected the EUC portion of its enterprise to become a progressively smaller component of the Company as a whole, Michael Dell aspired to,¹¹ and believed he would, continue to grow the PC business in the long run.¹² In fact, despite "deterioration in PC demand" and "macro changes in how people used PCs – the tablet impact, the smartphone impact," Dell believed as late as July 2012 that the PC business would grow at a rate of 1-2% in the long term.¹³

By December 2012, Dell was well poised to complete its transformation, having acquired all that it "needed" to execute the plan.¹⁴ In fact, Michael Dell took to the podium during an analyst conference on May 29, 2013 and proudly proclaimed:

¹¹ Dell 170:2-5; JX834.

¹² Mandl 17:6-18:5.

¹³ Gladden 48:19-49:24, 118:5-10, 119:14-19.

¹⁴ In fact, in a December 2012 presentation made to banks in connection with efforts to secure financing for the Transaction, Dell was represented to have "**completed** [its] transformation from PC focus to provider of end-to-end IT solutions." JX243 at 3 (emphasis added); JX669 at DELLE00779558 (Ratings Agency Presentation notes: "Future acquisitions are expected to be complementary rather than transformational in nature.").

In recent years, Dell has emerged as a new company. We have our strongest-ever product and services portfolio, and have acquired significant new skills and capabilities, reorganized our operations, optimized our global supply chain and put in place a world-class management team. ... *Today Dell is a customer-inspired end-to-end solutions provider. One that has evolved from a PC manufacturer to a true IT solutions partner* – one that offers a differentiated view of the enterprise.¹⁵

As of the date of the closing, Silver Lake – the private equity firm with which Michael Dell partnered to take the Company private – viewed the transformation as *complete*.¹⁶

Despite the substantial progress Dell had made in its bid to transform, the market was not crediting Dell’s transformation and the Company’s stock price lagged. According to a January 2011 sum of the part analysis Dell performed, the Company was worth \$22.49 per share (by line of business) or \$27.05 per share (by business unit).¹⁷ Dell stock at this time was trading around \$14 – a substantial discount.

¹⁵ JX530 at DELLE00238240.

¹⁶ JX730 (Durban quoted: “What in fact has happened, however, is an incredible thing. Michael *has already transformed* Dell into a thriving enterprise company.”); Durban 59:7-14 (Dell “had transformed itself into an enterprise company at the time of the closing.”); JX239 at DELLE0164880 (“Transformation completed. Acquisitions have filled key capability gaps.”).

¹⁷ JX44 at DELLE00148383.

Similarly, a July 2012 presentation to the Board by CFO Brian Gladden suggested that Dell was worth \$40 billion at the end of the 2012 fiscal year based on “[i]ndustry revenue multiples,” while the Company’s trading price suggested an enterprise value of approximately \$15 billion – a \$25 billion “valuation discount.”¹⁸ Gladden’s presentation further noted that while assuming the prior twelve months’ free cash flow into perpetuity suggested that Dell was worth in excess of \$30 per share, the “[c]urrent [market] valuation implie[d] annual 20% declines in free cash flow in perpetuity.”¹⁹ Dell’s Investor Relations department attributed this disconnect to the fact that “Dell [was] still seen as a PC business” – *i.e.*, the market was not giving Dell’s transformation any credit.²⁰ Silver Lake also noted that Dell “trade[d] at a discount to many other comparable companies,”²¹ including HP, which Silver Lake considered Dell’s “closest comparable company.”²²

¹⁸ JX97 at DELL00017564.

¹⁹ JX97 at DELL00017558.

²⁰ JX44 at DELLE00148383.

²¹ JX293 at SLP_DELLAP00116634.

²² JX99 at SLP_DELLAP00003359.

Given the wild disconnect between their internal analyses and the trading price of the Company's stock, Michael Dell and other key members of management repeatedly lamented that the market just "didn't get" Dell, as they fervently believed that the Company's public trading price did not reflect the Company's true value.²³ Dell management was not alone in this view, as lenders and advisors to the Company²⁴ and advisors to the Special Committee²⁵ noted that Dell's true value was not reflected in the market price of the Company's shares.

With Dell stock trading at a substantial discount to its intrinsic value, the time was ripe for an opportunistically timed buyout. During 2012, Dell's stock price dropped from a high of \$18.32 on February 16, 2012 to a low of \$8.86 on

²³ Dell 409:25-410:22; JX532 at 27.

²⁴ JX172 at DELLE00302211 (Dell financial advisor Goldman Sachs reported that the "Company's public market valuation was disconnected from valuation fundamentals"); JX170 at DELL00002462 ("Denali's share price performance and public trading multiples have lagged those of its peers, likely due to a range of factors, including ... a broad disconnect from valuation fundamentals as a result of industry disruption"); JX170 at DELL00002464 ("Companies at the center of industries undergoing major structural changes often suffer from depressed valuations that seem 'disconnected' from fundamentals ... valuations can remain depressed for protracted periods."); JX263 at Barclays-Dell-00062860 ("Denali trading at historically low valuation despite strong fundamental performance and cash flow.").

²⁵ JX230 at DELLE00302230 (Gerry Hansell of BCG stated that the Company had "significant positional strengths, which he believed were not reflected in its public market valuation").

November 16, 2012.²⁶ Michael Dell decided to take the Company private during this time of bargain-basement prices. In June 2012, as the price of the Company's stock declined, deepening the fundamental disconnect between the market price and the Company's true value, Michael Dell discussed the possibility of going private with Southeastern, one of Dell's largest outside shareholders.²⁷ Michael Dell had further discussions with private equity firms Silver Lake and KKR in August 2012.²⁸ Michael Dell ultimately chose to work with Silver Lake to take the Company private.

On August 14, 2012, Michael Dell approached Alex Mandl, the Company's lead outside director, and told Mandl that he was interested in exploring the possibility of taking the Company private.²⁹ The Board formed a Special Committee to evaluate the Company's strategic alternatives and to consider any offer that Michael Dell or any other parties might make.³⁰ The Special Committee

²⁶ PTO ¶67, Ex.A.

²⁷ JX532 at 20.

²⁸ JX532 at 20.

²⁹ JX532 at 20.

³⁰ JX532 at 21.

hired JPMorgan to serve as its financial advisor.³¹ Under the terms of its retainer, JPMorgan stood to earn \$30 million if, *but only if*, a transaction closed.³²

On October 9, 2012, JPMorgan presented its first DCF analysis to the Special Committee. JPMorgan's DCF on the then-current set of management projections – the “September 21 Case”³³ – suggested that Dell was worth between \$20 and \$27 per share.³⁴ Dell's stock, however, was trading at \$9.66.³⁵ JPMorgan's DCF analysis, therefore, made clear that a potential acquirer would have needed to offer a *107% premium* to give Dell's shareholders a price at the *bottom end* of the range suggested by a DCF on the September 21 Case.³⁶

JPMorgan also produced an illustrative LBO analysis.³⁷ This analysis suggested that an LBO at a price over \$19 per share would not be feasible, because the market would not have allowed Dell to take on the level of leverage needed to

³¹ JX532 at 22.

³² JX133.

³³ PTO ¶270.

³⁴ JX162 at DELLE00433689.

³⁵ *Id.*; PTO ¶67, Ex.A.

³⁶ Rajkovic 128:14-18.

³⁷ JX162 at DELLE00433699-700.

support that purchase price.³⁸ An “ability to pay” analysis suggested that a purchaser who accepted a valuation based on the September 21 Case would be able to pay only about \$14.13 per share – nearly \$6 per share below the low end of JPMorgan’s DCF based on the September 21 Case.³⁹ Although JPMorgan’s analysis made clear to the Special Committee that it would *never* be able to obtain a price for Dell in the context of an LBO that approached the value of the Company based on the September 21 Case, JPMorgan did not advise the Special Committee against pursuing an LBO. Doing so would have put its \$30 million success fee at risk.⁴⁰

On October 23, 2012, Silver Lake submitted a non-binding proposal to acquire all Dell shares other than those owned by Michael Dell (which he would roll over into the new company) for between \$11.22 and \$12.16 per share.⁴¹ This proposal valued Dell at about 60% of what the September 21 Case suggested the Company was worth.

³⁸ *Id.* at DELLE00433689 & DELLE00433699-700; Rajkovic 106:15-107:3 (an LBO of Dell at \$19 would “not be possible for the company”).

³⁹ JX162 at DELLE00433701; Rajkovic 113:15-16 (“So if they assume the 9/21 case, you can get \$14.13.”).

⁴⁰ Rajkovic 134:11-135:13.

⁴¹ JX532 at 27.

In formulating the price it was willing to offer for Dell, Silver Lake *made no attempt whatsoever* to value Dell as a going concern.⁴² Nor did Silver Lake form a view on whether the market price of Dell’s stock reflected the Company’s true worth.⁴³ Rather, Silver Lake just figured out how much leverage it could put on the Company, what the Company would be worth at Silver Lake’s target investment horizon, and how much Silver Lake could pay without jeopardizing its ability to meet an appropriate rate of return.⁴⁴ The price offered, accordingly, had *nothing* to do with what Dell was worth as a going concern⁴⁵ and *everything* to do with what Silver Lake could pay without jeopardizing its ability to secure the substantial return it expected to earn on its investment.⁴⁶

⁴² PTO ¶132; Durban 67:1-68:18.

⁴³ Durban 68:19-22.

⁴⁴ Durban 13:17-14:1.

⁴⁵ Durban 73:13-74:20 (“[W]e were all constantly looking at the transaction as we designed it, which was a much different investment proposition than somebody else who is looking to value the company.”).

⁴⁶ Before it submitted its initial indication of interest, Silver Lake projected that it would earn a return of 32% (a 3x times MoM) on its investment in Dell, assuming a \$12 per share purchase price and a January 2017 exit at a 4.0x trailing EBITDA. JX716 at SLP_DELLAP00116464. Before it submitted its \$13.65 offer, Silver Lake projected that it would earn an annual return of 34% (a 2.8x times MoM) on its investment, assuming a \$13 per share purchase price and a January 2017 exit at a 4.0x trailing EBITDA. JX293 at SLP_DELLAP00116628.

* * *

The Special Committee’s claim that it tried to get the best price it could for Dell’s shareholders in a sale context, including hiring Evercore as a second financial advisor to conduct a “go shop,”⁴⁷ misses the point. Even if the Special Committee squeezed every nickel out of Silver Lake that it was willing to pay, the Dell take private transaction represented the *lowest valuation at which any major company had ever gone private*.⁴⁸ Selling the Company at the trough was not the way to obtain the true value for the shareholders; it was simply an opportunistic way for Michael Dell and Silver Lake to reap the benefits of the transformation at the expense of the shareholders. *It is the fair value of Dell as a going concern – not the highest price obtainable in a sale context, or in a leveraged buyout in particular – that is at issue in this appraisal action.*⁴⁹ The merger price was

⁴⁷ JX532 at 34-35.

⁴⁸ JX437 (noting that the \$13.65 price then on the table represented “less than 8 times earnings” and that “[n]o major company has even gone private at such a low valuation”); Dell 47:15-22 (Michael Dell aware that “multiples of revenue for a company like ours would be at the lower end of all companies, whether they were public or private or going private”).

⁴⁹ *M.P.M. Enters., Inc. v. Gilbert*, 731 A.2d 790, 795 (Del. 1999) (“Fair value, as used in § 262(h), is more properly described as the value of the company to the stockholder as a going concern, rather than its value to a third party as an acquisition.”); *Golden Telecom, Inc. v. Global GT LP*, 11 A.3d 214, 217 (Del.

\$13.75.⁵⁰ The fair value of Dell as a going concern as of the date of the Transaction was \$28.61 per share, to which Petitioners are entitled, plus interest.

ARGUMENT

The evidence will demonstrate that Dell was a fundamentally strong company with robust cash flows and a promising future. Its founder and CEO determined to take the Company private and cash out its shareholders at a time of historically low share prices. Although the PC industry undoubtedly was in flux at the time of the Transaction, even conservative assumptions regarding Dell's future operations reveal an intrinsic value far in excess of what Silver Lake and Michael Dell chose to pay. An appropriately conducted discounted cash flow analysis using (a) projections endorsed by the Special Committee and relied on by investors and (b) contemporaneous projections created by the Company's purchasers for the

2010) (“[T]his Court has defined ‘fair value’ as the value to a stockholder of the firm as a going concern, as opposed to the firm’s value in the context of an acquisition or other transaction.”); *Highfields Capital, Ltd. v. AXA Fin., Inc.*, 939 A.2d 34, 42 (Del. Ch. 2007) (“It is well established that ‘fair value’ for purposes of appraisal is equated with the corporation’s stand-alone value, ‘rather than its value to a third party as an acquisition.’”).

⁵⁰ While an additional thirteen cent dividend was negotiated as part of the deal, *all* Dell shareholders – even those who declined to accept the \$13.75 merger price to pursue an appraisal remedy – were paid this dividend, such that it is not properly considered part of the deal price. Durban 182:6-183:1.

purpose of securing financing, demonstrates that Dell was worth \$28.89 per share on the day the Transaction closed.

Although the amount of the dispute between Petitioners and Respondent is great, the issues in dispute are limited. Both experts agree that a DCF analysis is the proper method to value Dell. Both experts generally agree which projections should be used. Where there is disagreement, the effect of that disagreement often is not large (such as the WACC dispute) or is the opposite of what one might think (PGR – Respondent’s is larger than Petitioners’). But some significant disputes do exist that have a substantial financial effect on the valuation of Dell. The bulk of those disputes concerns six issues, three of which impact the DCF and three of which concern adjustments to the value derived from the DCF.

The major issues concerning the DCF are: (1) whether the BCG Cases should be “adjusted” by (a) revising them downward to account for already-baked-in projections concerning a decline in the PC market, and (b) extending them linearly to allow for the expenditure of additional capital investment to accommodate a *higher* terminal growth rate than Petitioners suggest; (2) the amount of cost savings that should be included in the cash flow projections; and (3) Dell’s tax rate in the projection and terminal periods.

The major issues concerning the post-DCF adjustments are: (1) whether any deduction should be made from Dell’s excess cash for working capital, and if so, how much; (2) whether a liability exists for deferred taxes, and if so how much, and whether any such liability should be deducted from the value of Dell; and (3) whether an accounting convention for contingent tax liability (FIN 48) should be deducted from the value of Dell, and if so, by how much.

I. ISSUES REGARDING THE DISCOUNTED CASH FLOW VALUATION OF DELL

A. Professor Cornell Appropriately Considered The BCG 25% And 75% Cases And The Bank Case

1. The BCG Cases And The Cost Savings Overlay

In November 2012, the Special Committee instructed BCG – one of its financial advisors⁵¹ – to prepare an independent assessment of the Company’s financial prospects.⁵² To do so, BCG (i) created a “Base Case” that forecasted Dell’s financial performance without giving any credit to the Company’s ability to implement a \$3.3 billion cost savings plan that had been identified and started by management and (ii) modeled two “overlays” (a “25% Case” and a “75% Case”)

⁵¹ JX532 at 28.

⁵² Ning 78:20-79:1 (stating that the Special Committee instructed BCG to create an alternative set of financial projections).

that showed incremental increases to the Base Case assuming that the Company was able to execute its cost savings plan.⁵³ JPMorgan used the BCG model (and the 25% Case in particular) at the Special Committee’s direction.⁵⁴ The BCG model also served as the basis for the Special Committee’s presentations to investors just months before the Transaction.⁵⁵ Tellingly, the experts retained by both Dell and Petitioners rely on the BCG model in constructing their respective DCF analyses. Underscoring the propriety of relying on the BCG Cases, the Special Committee believed BCG’s advice to be “extremely objective, fact-based” and “valuable.”⁵⁶

The BCG Base Case assumed, among other things, that (1) PC units sales would remain nearly flat through FY17; (2) Dell would lose share in the overall PC

⁵³ PTO ¶¶271-72; JX293 at SLP_DELLAP00116572 (“\$3B cost savings opportunity” listed among “various value creation opportunities [that] provide *incremental upside to base case model*”) (emphasis added); JX720 at DELLE00280075 (Houlihan Lokey noting that it “relied upon the Bank Case projections as prepared by Company management. *Incremental cost savings of up to \$1 billion have not been factored into the financial projections* or included in the financial analysis.”) (emphasis added).

⁵⁴ PTO ¶274; Rajkovic 171:1-6. The Special Committee’s other advisor, Evercore, also used the BCG Cases in its fairness analysis. JX532 at 70-79.

⁵⁵ JX542 at DELLE00390269-271 (focusing its discussion of projections on the BCG cases).

⁵⁶ Nicol 83:18-22.

market, with an overall share decline from 11% to 8%; (3) Dell's share in premium PC segment would hold constant; (4) Dell's gross margin over the forecast period would be consistent with historical margin performance by price tier; (5) Dell would develop a modest position in the tablet market; (6) software and peripherals attachments would comprise 24% of EUC revenue; (7) Dell would earn \$50 per PC sold in support services; and (8) New Dell businesses would grow at an underlying segment growth rate, leading to growth rates for FY13-FY17 of 4.5% for revenue and 7% for gross margin.⁵⁷ The BCG Base Case, however, assumed that Dell's then-existing cost structure would remain constant and did not account for Dell's projected productivity savings.⁵⁸

Beginning in June 2012, Dell began to work on a productivity initiative designed to remove significant costs.⁵⁹ By no later than January 2013, Dell had identified \$2.8 billion in cost savings that could be implemented to achieve a \$3.3

⁵⁷ JX279 at BCG00063748.

⁵⁸ JX237 at BCG00042878 (“base forecast should not assume productivity gains”).

⁵⁹ PTO ¶257; JX84 at DELLE00339895.

billion “affordability target.”⁶⁰ To account for these cost savings, BCG created the 25% and 75% Cases.

The 25% Case was based on two specific initiatives that BCG had high confidence Dell would achieve: (a) labor arbitrage to China due to a shift in inventory model; and (b) delayering the organization.”⁶¹ Because these two initiatives would have resulted in Dell achieving \$825 million in cost savings (*i.e.*, approximately 25% of the \$3.3 billion “affordability target”), this case came to be called the “25% Case.”⁶²

The 75% Case was based on BCG’s determination that, because Dell had been able to achieve 75% of the savings that had been identified as part of a 2009 “client reinvention” initiative, it would assume that Dell would achieve approximately 75% of the \$3.3 billion identified savings – *i.e.*, \$2.475 billion. This case came to be called the “75% Case.”⁶³

⁶⁰ JX278; JX318 at JPM_0073632 (“To date, \$2.8 billion, 85%, of the cost savings ideas have been identified by management with plans in place to increase idea pipeline.”).

⁶¹ JX279 at BCG00063749; Ning 189:15-191:9.

⁶² JX542 at DELLE00390269.

⁶³ JX279 at BCG00063749; Ning 191:10-21; JX542 at DELLE00390269.

Three aspects of BCG's model are crucial to understand for purposes of this case. First, the cost savings identified would be phased in over three years, reaching the respective 25% and 75% levels by 2016.⁶⁴ Second, BCG's model was designed such that the cost savings would be *incremental* to the Base Case, meaning that the cost savings achieved would directly increase the Company's projected EBITA.⁶⁵ Third, the Base Case assumed that PC prices would *decline* by 4% annually based on competition. As BCG itself explained, "[t]he base case forecast revenue already had market driven price declines built in (-4% per year) – the cost reduction is incremental."⁶⁶

It was important for BCG to model the billions of dollars of identified cost savings given (i) management's track record in "making good" on identified cost initiatives and (ii) that anticipated changes in Dell's cost structure would impact the Company's earning power projected in BCG's model. In fact, in preparing for presentations to rating agencies, Dell management specifically noted, "***There will likely be some pushback as to the emphasis on the 25% Case since there is not a***

⁶⁴ JX344 at DELL00002286 ("Ramp rate is 10% in '14, 50% in '15, 100% in '16").

⁶⁵ Nicol 74:16-75:25.

⁶⁶ JX512 at BCG00056615; JX516 (noting that the cost reduction was additive because the price decline was built in).

history of Dell delivering only a small portion of publicly-announced cost-out initiatives.”⁶⁷ The Company ultimately represented in a presentation to rating agencies in August 2013 that it had “identified and was executing against a \$3.6 billion funnel of productivity initiatives to maintain and improve competitive position”⁶⁸ – cost savings that Michael Dell admitted the Company included in this presentation only because “we thought we had a legitimate chance of achieving these cost-savings opportunities.”⁶⁹

Dell’s post-closing reports on cost savings confirms the Company’s actual success in implementing those savings initiatives. As of November 24, 2013, less than one month after the closing date, Dell management believed it was “on track” to deliver \$1.4 billion in cost savings for FY2014 – which ended on January 31, 2014.⁷⁰ A Rating Agency Presentation made by the Company in April 2014 reported that Dell had “*realized \$1.6B in FY14*” in cost savings, with another \$1.5

⁶⁷ JX495 at JPM_0021309 (emphasis added); JX456 at JPM_0129442 (“typically there is a good conversion of loaded savings into actual savings”).

⁶⁸ JX669 at DELLE00779577.

⁶⁹ Dell 299:19-300:1.

⁷⁰ JX743.

billion expected in 2015.⁷¹ This was well in excess of the phased-in projected savings for FY2014 of \$84 million and \$251 million in the 25% and 75% Cases, respectively.⁷² BCG admitted during its deposition that if Dell had achieved this \$1.6 billion of cost takeouts during FY2014, then in October 2013 it would have been “*right to rely on the [BCG] base case plus one of the management initiatives* that we had stated ... [I]f they had already achieved the 50%, then it was reasonable to rely on 50%.”⁷³

That the cost savings achieved in FY2014 might not have resulted in an immediate dollar-for-dollar increase to EBITA does not militate against using the estimated cost savings for at least two reasons. *First*, the BCG Cases were meant to assess Dell’s long-term earning power. After BCG prepared its Base Case, Dell management made a strategic decision to drop the prices of certain PCs to gain market share.⁷⁴ While this strategic decision may have impacted Dell’s EBITA in

⁷¹ PTO ¶267; JX807 at DELLE00216702.

⁷² *Supra* n.64 (10% in FY2014); JX307 at DELLE00301537; Cornell Rpt. Ex. 1B.

⁷³ Ning 268:14-269:13.

⁷⁴ JX518 (referencing Dell’s “stated shift to trade margin for share”).

the *short term*, it did not impact Dell’s earning power in the *long-term*.⁷⁵ In fact, BCG itself believed that this short-term decision to trade margin for share had *no impact* on Dell’s long-term earning power⁷⁶ and therefore told the Special Committee that its model remained sound despite a strategic decision that negatively impacted EBITA.⁷⁷ *Second*, the full amount of these cost savings could have hit the bottom line in their entirety but did not only because Dell *chose* to

⁷⁵ JX512 at BCG00056615 (“Q1 update EBITA annualizes to \$2.5B compared to a BCG base case forecast of \$3.4B. How does this affect BCG’s view on the base case FY15 and FY16 earnings power? ... Results more due to [product] mix shift, not a fundamental shift in earnings power.”); JX531 at DELLE00626558 (“EUC shortfall (\$450M) was caused by a Dell stated shift to trade margin for share, to drive ESS cross-selling; Not a fundamental reset”).

⁷⁶ Nicol 125:14-126:17; JX531 at DELLE00626558 (“We don’t believe the long-term earnings power of Dell will change due to Q1 but in the short-term, Dell’s actions in EUC, ESG have the business trending toward \$2.9B Op Inc in FY14”).

⁷⁷ Nicol 163:14-164:16 (BCG told the Special Committee in May 2013 that its “original model was still viable” despite Dell EBITA miss in 1Q 2014; Special Committee did not ask BCG to update the model because the Committee understood that “there had been a change in the performance of the business, but it was driven by a management action that was really affecting the volume and price of the units, but [BCG] didn’t think there was any underlying change in the business model”).

reinvest the money back into the business.⁷⁸ Because this reinvestment was a tactical decision that reduced the short-term earnings of the Company in the months preceding the Transaction, it should not be used to lower the appraised value of the Company. *Delaware Open MRI Radiology Assocs. v. Kessler*, 898 A.2d 290, 315 (Del. Ch. 2006) (strategic decision that negatively impacted valuation should not be taken into account in valuing corporation in appraisal action).

2. The Bank Case

Silver Lake prepared the Bank Case and used it to obtain financing for the deal. The Bank Case was prepared with “extensive input” from Dell management⁷⁹ and effectively was endorsed by Michael Dell himself. Indeed,

⁷⁸ PTO ¶264; JX518 at BCG00002302 (quoting Gladden: “I wouldn’t say we haven’t executed on cost initiatives ... We are just choosing consciously to reinvest those dollars and sales resources and R&D resources in the software business, things that we’ve talked about over time being important to the future of the company ... [W]e’ve chosen to reinvest those savings that were driving as part of that initiative and important investments for the future of the company. That’s just what we’ve decided to do.”); Sweet 301:23-302:2 (to extent cost savings were reinvested into the business, that was Dell’s choice); 305:12-306:9 (\$1 billion in costs savings were projected to drop to the bottom line; to the extent they did not, it was because Dell made a conscious choice to reinvest).

⁷⁹ Durban 211:9-17; JX720 at DELLE00280075 (Houlihan Lokey noting that it “relied upon the Bank Case projections *as prepared by Company management*”) (emphasis added).

Michael Dell reviewed the projections⁸⁰ and thereafter allowed them to be used to market the deal to rating agencies and debt participants.⁸¹ The Bank Case initially was prepared in January 2013, subsequently revised in August 2013, and presented to investors in September 2013. The Bank Case took a “conservative approach to the PC market outlook vis-à-vis Gartner and IDC analysts’ expectations.”⁸²

The Bank Case, as revised, was the set of projections created most closely in time to the Transaction. Silver Lake and Michael Dell used these projections to obtain billions of dollars in financing from banks. These projections were relied on not just by the banks but by debt investors and rating agencies. Respondent would be hard-pressed to now disclaim as inaccurate the very projections that Dell’s purchasers created and that the Company used to secure billions of dollars in financing.⁸³

⁸⁰ Dell 216:16-217:1 (Michael Dell “looked at” the multiyear projections used in the Bank Case and “they looked fine”); Sweet 17:16-18:1 (Bank Case was “generally a reasonable, you know, financial projection, given what we knew at the time”).

⁸¹ Durban 224:20-226:16.

⁸² JX290 at SLP__DELLAP00007204.

⁸³ *Owen v. Cannon*, 2015 WL 3819204, at *20 (Del. Ch. June 17, 2015) (“[B]ecause it is a federal felony ‘to knowingly obtain any funds from a financial institution by false or fraudulent pretenses or representations,’ projections that are

While the Bank Case purportedly gave effect to the Transaction, and thus modeled Dell as a private company, there is nothing to suggest that the model would have been significantly different if the projections applied to Dell as a public company. After all, when Michael Dell explained to the Special Committee what he sought to do with the Company after the go-private, he did not mention *a single initiative* that Dell could not have accomplished as a public company.⁸⁴

Like BCG's Base Case, however, the Bank Case did not include any cost savings initiatives that Dell management had identified and on which management was executing in the year preceding the merger.⁸⁵ Silver Lake performed a "Returns Sensitivities" analysis on the Bank Case to evaluate how its projected

provided to a financing source are typically given 'great weight'" by the Court of Chancery) (quoting *Open MRI*, 898 A.2d at 332 n.109).

⁸⁴ JX532 at 31; JX231. While Dell representatives repeatedly suggested that accomplishing these initiatives as a public company would be hard because Dell's shareholders would not stomach the risks (Durban 62:11-64:3), as the Court recently recognized, such a proposition "turns traditional principles of limited liability and diversification upside down. Diversified public stockholders should be less risk-averse, precisely because of their diversification, than a large stockholder with non-diversified risk." *In re Dole Food Co., Inc. S'holder Litig.*, 2015 WL 5052214, at *47 n.14 (Del. Ch. Aug. 27, 2015) (citing *Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049, 1052 (Del. Ch. 1996) ("Shareholders don't want (or shouldn't rationally want) directors to be risk averse.")). Moreover, long-time shareholders like the T. Rowe Price Petitioners had been accepting this risk throughout the 4 years immediately preceding the Transaction.

⁸⁵ See n.53, *supra*.

rates of return would be impacted if the cost savings were actually achieved. This analysis showed that the realization of cost savings would have a tremendous impact on Silver Lake's rate of return. While Silver Lake projected that its rate of return on a \$13 per share buyout assuming a 2017 exit with no cost savings would be 33.9%, the rate would increase to: (i) **39.8%** if \$500 million in cost savings were achieved, (ii) **45.1%** if \$1 billion in cost savings were achieved, (iii) **50%** if \$1.5 billion in cost savings were achieved, and (iv) **54.5%** if \$2 billion in cost savings were achieved.⁸⁶

When presenting the Bank Case to potential investors, Silver Lake identified \$1 billion in cost savings that were "incremental" to the financial plan and showed the impact of those savings on Dell's projected EBITDA.⁸⁷ Petitioner's expert, Professor Bradford Cornell, included the incremental savings identified by Silver Lake in the "Bank Case with Cost Savings."

3. Professor Cornell Appropriately Weighted The BCG Forecasts And the Bank Case Forecast

Professor Cornell reviewed the BCG Cases, the Bank Case, and evidence indicating that, by the Appraisal Date, Dell had successfully executed on at least

⁸⁶ PTO ¶278; JX293 at SLP_DELLAP00116629

⁸⁷ JX679 at DELLE00238978, DELLE00239047

\$1.6 billion of the identified \$3.3 billion in cost savings and had plans to implement another \$1.5 billion in cost savings in FY2015. Professor Cornell relied on the BCG 25% Case, the BCG 75% Case, and the Bank Case with Cost Savings in conducting his DCF.⁸⁸ To perform his valuation, Professor Cornell accorded an equal 25% weight to each of the BCG 25% and 75% Cases,⁸⁹ which resulted in the mathematical equivalent of using a BCG 50% Case.⁹⁰ Critically, BCG acknowledged that use of a 50% case would have been reasonable if Dell achieved 50% of its cost savings in FY2014,⁹¹ which, as described above, it did.⁹² Professor Cornell then weighed this BCG 50% Case equally with the Bank Case with Cost Savings to reach his conclusion.

Professor Cornell's weighing of the BCG 50% Case with the Bank Case with Cost Savings is reasonable. The reasonableness of relying on the BCG Cases is beyond peradventure because the BCG model was endorsed by the Special

⁸⁸ Cornell Rpt. ¶86.

⁸⁹ Cornell Rpt. ¶91.

⁹⁰ Cornell Rpt. ¶91.

⁹¹ Ning 268:14-269:13.

⁹² JX807 at DELLE00216702 (Dell achieved \$1.6B in cost savings in FY 2014, which ended in January 2014).

Committee,⁹³ which thereafter re-hired BCG for other advisory services,⁹⁴ revealing the Special Committee’s confidence in BCG’s work. Consideration of the Bank Case was also reasonable. First, the Bank Case was prepared closest in time to the closing of the Transaction. *In re Orchard Enters., Inc.*, 2012 WL 2923305, at *13 (Del. Ch. July 18, 2012) (adopting fairness opinion projections “because they were prepared closest to the Going Private Merger and they are therefore the best indicator of Orchard management’s then-current estimates and judgments”). Second, Silver Lake (with Michael Dell’s approval) presented the Bank Case to several banks in connection with its efforts to obtain financing for the transaction. This Court places “great weight” on projections used to obtain financing due to potential criminal liability for making false statements to financial institutions. Under these circumstances, the use of the Bank Case With Cost Savings is appropriate. These adjustments are well-grounded in the record evidence. The supplementing of the Bank Case with management-identified cost savings is not the sort of *post-hoc* litigation-driven adjustments of which this Court is skeptical.

⁹³ PTO ¶274.

⁹⁴ Nicol 81:12-84:1.

B. The BCG Forecasts Do Not Have To Be “Revised”

Professor Cornell accepted the BCG forecasts as prepared by BCG, approved by the Special Committee, and used by the Special Committee’s financial advisor JP Morgan.⁹⁵ Dell’s expert, Professor Hubbard, however, begins his analysis by making two significant “revisions” to the BCG forecasts designed to lower his ultimate valuation of Dell. First, Professor Hubbard revised the BCG forecasts downward purportedly to reflect a decline in PC sales post-January 2013.⁹⁶ Second, Professor Hubbard extended the BCG projections linearly by five years as a “transition period” to add additional investment that he then uses to support a *higher* terminal growth rate than Professor Cornell adopted.

1. The BCG Forecasts Did Not Have To Be Revised Downward To Reflect A Decline In PC Sales

After BCG prepared its forecasts, industry analyst IDC published forecasts that anticipated declines in the PC industry. Professor Hubbard revised the BCG forecasts downward by significant amounts to, in his words, “update[] the August 2012 IDC forecast that BCG used in its model with the August 2013 IDC

⁹⁵ PTO ¶¶272, 274; Cornell Reb. ¶13 (citing JX931 and JX650); Rajkovic 154:17-22 (Special Committee instructed JP Morgan to use the BCG forecast); Rajkovic 222:18-223:2 (JP Morgan instructed to focus on BCG 25% case).

⁹⁶ Hubbard manipulated the Bank Case in a similar manner. Hubbard Rpt. ¶194.

forecast.”⁹⁷ Had he not made this change, his estimation of Dell’s value would have been higher by \$1.35 per share.

Professor Hubbard’s alteration of the BCG Cases is entirely unjustified and renders his valuation analyses unreliable. By modifying the BCG Cases in this manner, Professor Hubbard substituted his own judgment for that of the Special Committee and its advisor. In fact, BCG’s model *already* reflected an expected decline in PC sales.⁹⁸ For this reason, once the expected declines began to manifest, BCG and the Special Committee determined *not* to further revise the projections.⁹⁹ Professor Hubbard’s adjustment is precisely the type of litigation-driven modification that this Court rejects.¹⁰⁰

Professor Hubbard’s downward adjustment is also inconsistent with the fact that Dell management was skeptical of IDC forecasting.¹⁰¹ The August 2013 IDC forecast reflected the belief that the market outlook for desktop and notebook PCs

⁹⁷ Hubbard Rpt. ¶192.

⁹⁸ Nicol 100:16-101:14; 112:13-18 (“[F]rankly, we had anticipated this [decline] in our previous analysis and modeling.”).

⁹⁹ Nicol 114:14-23.

¹⁰⁰ *Merion Capital L.P. v. 3M Cogent Inc.*, 2013 WL 3793896 (Del. Ch. July 8, 2013).

¹⁰¹ Gladden 78:5-79:15.

had deteriorated – a view that neither Silver Lake nor Dell management shared.¹⁰² BCG and the Special Committee could have – but did not – update the projections to account for the August 2013 IDC projections.¹⁰³ This decision speaks volumes. Further, Professor Hubbard failed to explain why – even if he believed post-January 2013 adjustments to the BCG Cases were necessary – he did not consider (a) industry data from IDC competitor Gartner, which was more optimistic than that of IDC,¹⁰⁴ or (b) positive changes in the market for Dell’s non-PC products and services, such as cloud computing, servers, and other enterprise-oriented business lines.¹⁰⁵ For example, a Goldman Sachs study projected that cloud computing spending – an area in which Dell had made significant investments – was expected to grow at a 30% CAGR from 2013 to 2018.¹⁰⁶ Professor Hubbard,

¹⁰² JX669 at DELLE00779571-72.

¹⁰³ Hubbard 120:12-122:1.

¹⁰⁴ Hubbard 70:4-71:16 (noting that he used IDC projections without considering or reviewing the Gartner projections). While Professor Hubbard may not have considered Gartner projections to be sufficiently significant to address, BCG did: Nicol testified that BCG believed Gartner projections were as relevant as IDC projections. Nicol 106:1-3.

¹⁰⁵ Hubbard 79:16-25 (noting that while he made adjustments to Dell’s revenue projections as a result of IDC’s PC forecasts, he did not consider forecasts for any of Dell’s other business lines).

¹⁰⁶ JX853.

however, did not take into account the growth in this spending when making his *post hoc* adjustments to the BCG Cases.¹⁰⁷ Similarly, in August 2013 Gartner was predicting that growth in enterprise technology spending would be double in 2014 what it was in 2013, yet Professor Hubbard failed to take any of this information into account when “updating” the BCG Cases.¹⁰⁸

Professor Hubbard’s failure to properly account for these changes might be explained by his admission during his deposition that he had *no expertise* that would enable him to determine how a macro change in the computer industry – like the one embodied in the IDC forecast – would impact Dell specifically such that it would even be proper to simply “plug in” revised IDC data as a proxy for Dell’s expected performance.¹⁰⁹

In connection with his “update” to the BCG forecasts, Professor Hubbard also unilaterally lowered the attachment rates that were used to estimate S&D revenue as a function of the underlying hardware revenue in the Hubbard Adjusted

¹⁰⁷ Hubbard 80:14-82:7; JX853.

¹⁰⁸ Hubbard 82:14-84:5.

¹⁰⁹ Hubbard 132:19-25. Notably, while the revised August 2013 IDC forecasts projected a decline in PC sales as compared to its 2012 forecasts, Dell’s own market share increased 8% during this same time period – a fact that Professor Hubbard did not consider in making his downward adjustment to the BCG 25% Case. Hubbard 179:15-180:25.

BCG Case.¹¹⁰ This revision lowered Dell’s projected S&D revenue and reduced Dell’s projected cash flows from what BCG forecasted in the Base Case. These adjustments were driven solely by the adjustments Professor Hubbard made in light of his “updated” IDC forecast. Because this adjustment was improper, Professor Hubbard’s attachment rate adjustment was equally improper. Further, the attachment rates BCG used were provided by Dell management itself.¹¹¹ There is simply no basis for Hubbard to substitute his own judgment as to the appropriate S&D revenue in the BCG model for that of BCG, which obtained its information directly from Dell management.¹¹²

2. Professor Hubbard’s “Transition Period” Is Inappropriate

Professor Hubbard also created an entirely new set of projections by extending BCG’s forecasted model by 5 years to create a three-stage DCF model that includes (1) a 5-year projection period, (2) a self-created 5-year “transition period,” and (3) a terminal period.¹¹³ Professor Hubbard’s use of a “transition

¹¹⁰ Hubbard Rpt. ¶¶195-196.

¹¹¹ Ning 43-44.

¹¹² Professor Hubbard admitted during his deposition that he did not speak to any member of Dell management about attachment rates and that he himself chose the attachment rates used in his model. Hubbard 126:5-9; 126:20-22.

¹¹³ Hubbard Rpt. ¶200.

period” appears designed solely to reduce Dell’s projected cash flows in order to justify his selected terminal growth rate while lowering the value of the Company.

First, the use of a “transition period” is inappropriate. Rapid growth in a projection period that exceeds the growth of the national economy cannot be sustained in perpetuity.¹¹⁴ As such, a transition period *can* be a useful tool to normalize earnings in the long term when valuing an immature and rapidly growing business.¹¹⁵ But as Professor Hubbard acknowledged, Dell is a mature company with moderate growth prospects.¹¹⁶ Professors Cornell and Hubbard anticipate Dell’s long term PGR to be 1% and 2%, respectively – both well below the nominal GDP growth rate of 3.5%. The use of a transition period for purposes of valuing Dell is thus unsound.

¹¹⁴ *3M Cogent Inc.*, 2013 WL 3793896, at *21 (“[A] terminal growth rate should not be greater than the nominal growth rate for the United States economy, because ‘if a company is assumed to grow at a higher rate indefinitely, its cash flow would eventually exceed America’s gross national product’” (quoting Bradford Cornell, *Corporate Valuation: Tools for Effective Appraisal and Decision Making*, 146-47 (1993))).

¹¹⁵ *Andaloro v. PFPC Worldwide, Inc.*, 2005 WL 2045640, at *12 (Del. Ch. Aug. 19, 2005) (recognizing that “over time firms cannot continue to grow at a rate that is materially [higher] in excess of the real growth of the economy” and adopting a three-stage DCF that “explicitly” slowed growth from the “earlier periods of higher than typical growth”).

¹¹⁶ Hubbard Rpt. ¶¶58, 62.

Second, *if* a transition period is to be used, the projections during that period must be used to trend towards normalized growth rates or margins. Professor Hubbard’s transition period simply held constant the operating margins at the end of the projected period and superimposed additional investment that he assumes is necessary to support his chosen terminal growth rate. This has the concomitant result that Dell’s free cash flow is significantly reduced.¹¹⁷ Accordingly, Professor Hubbard’s “transition period” was not used to “normalize” anything but instead is designed to support his assumed terminal growth rate while reducing Dell’s value.

More specifically, after assuming that Dell would grow by 2% per year in perpetuity, Professor Hubbard worked backwards to determine the level of investment that he believed would be necessary to support his selected PGR.¹¹⁸ To perform this calculation, Professor Hubbard further assumed that Dell’s ROIC would equal its WACC.¹¹⁹ This is significant because it implies that Professor Hubbard believed the additional investments he was imposing on the model *would not generate any additional value for Dell.*¹²⁰ This expectation is directly

¹¹⁷ Cornell Reb. ¶20.

¹¹⁸ Cornell Reb. ¶23.

¹¹⁹ *Id.*

¹²⁰ *Id.*

contradicted by Dell's own investment history: when it paid \$14 billion for a number of acquired companies, Dell expected an internal rate of return of 15%,¹²¹ compared to its WACC of 8.5%. This expected return was not equal to Dell's WACC but far exceeded it. But even assuming the validity of Professor Hubbard's calculation of required investment to support growth, Dell's investments throughout the projection period used in the BCG forecasts and the Bank Case are more than sufficient to support Professor Cornell's application of a 1% terminal growth rate, rendering any extension of the forecasted period or additional investment to support growth unnecessary.¹²²

C. HUBBARD ARTIFICIALLY RAISED DELL'S TAX RATE IN THE TERMINAL PERIOD TO DRAMATICALLY LOWER DELL'S VALUE

In performing his DCF valuation, Professor Cornell applied the same 21% tax rate that the Special Committee's advisors used in their DCF valuations of Dell.¹²³ Although the average marginal corporate tax rate was 34% over the twenty-five year period leading up to the Transaction, Dell never paid anything

¹²¹ JX87 at DELLE00405746 ("15% + IRR Target for M&A Business Cases").

¹²² Cornell Reb. ¶¶21-30.

¹²³ JX329; JX650; JX360; JX632.

close to that rate.¹²⁴ In fact, Dell paid on average just 18.5% in taxes in the three years preceding the Transaction.¹²⁵

Professor Hubbard, in contrast, did not use Dell's *actual* effective tax rate but instead applied a different, lower tax rate during his "transition" period (18.5%) and a materially higher tax rate (35.8%) in the terminal period. In selecting a 35.8% tax rate for the terminal period, Professor Hubbard relied on the Shay Report, which proclaims that by 2023 (the beginning of Hubbard's terminal period), Dell would have *no choice* but to begin paying taxes on all of its worldwide income at the current federal marginal tax rate of 35%, supplemented by 0.8% for state taxes.¹²⁶

The assumption that Dell would begin paying 35.8% tax on all of its worldwide income in 2023 is unrealistic. *First*, Dell has extensive operations overseas.¹²⁷ In FY2013, Dell earned more than 50% of its revenue overseas.¹²⁸

¹²⁴ Sweet 60:10-14 (Sweet "not aware of any year" in which Dell paid the marginal tax rate).

¹²⁵ PTO ¶¶290-92; Cornell Reb. Ex. 5; JX393 (Dell's effective tax rates were 17.6% in FY2012 and 21.3% in FY2011).

¹²⁶ Shay Rpt. ¶¶41-45.

¹²⁷ PTO ¶¶279-80.

¹²⁸ PTO ¶279; JX682 at 40.

And in the future, Dell projected that its overseas operations would grow.¹²⁹ There is no factual basis to assume, therefore, that all of the sudden and for some unknown reason, in 2023 all of Dell's global income will magically be taxed in perpetuity at the highest marginal rate applicable to income earned in the United States.¹³⁰ And neither Professor Hubbard nor Professor Shay offers any plausible explanation for this assumption.

Second, the assumption that Dell will be taxed globally at the highest marginal rate applicable to domestic income for U.S. corporations is contrary to Dell's actual history. In the 25 years leading up to the Transaction, Dell's effective tax rate has always been *substantially below* the marginal rate.¹³¹ Dell's effective

¹²⁹ PTO ¶¶280; Dell 156-157 (Michael Dell expected to double the number of stores in India during FY2016 and to accelerate the pace of its investments in emerging markets); Gladden 202-203 (Dell had plans to increase its investment in India, Indonesia, and Brazil); Sweet 114:14-122:10 (detailing Dell's plans to continue to expand overseas operations).

¹³⁰ A presentation from November 2012 evaluated Dell's taxable income and blended tax rates for the Company's "Top 10" operating entities in the U.S., China, India, Brazil, Hungary, Japan, Mexico, and France. This analysis showed that over 73% of Dell's taxable income was earned outside of the United States, with global "Cash Tax Rates" in the U.S. at 33% and internationally ranging from 14.9% (in China) to 58.3% (in France). JX393 (DELLE00611808).

¹³¹ In fact, in performing post-closing valuation analyses, Houlihan Lokey was instructed by Dell management to assume a 17% tax rate. JX757.

tax rate averaged 23.8% in the ten years leading up to the Transaction and 18.5% in the three years leading up to the Transaction.¹³²

Finally, the tax rate applied in a DCF should reflect the corporation's "operative reality."¹³³ As a result, this Court has recognized that "[w]hen available and reliable, the historical tax rate will likely be appropriate."¹³⁴ Delaware law, therefore, favors application of a company's historical tax rate¹³⁵ and rejects deviations that lack a solid basis in fact.¹³⁶

¹³² PTO ¶¶287-92; Cornell Reb. ¶36.

¹³³ *In re AT&T Mobility Wireless Operations Holdings Appraisal Litig.*, 2013 WL 3865099, at *4 (Del. Ch. June 24, 2013) (adopting company's effective tax rate of 32.4% as being "[c]onsistent with the Companies' operative reality").

¹³⁴ *Crescent/Mach I Partnership, L.P. v. Turner*, 2007 WL 1342263, at *11 (Del. Ch. May 2, 2007).

¹³⁵ *Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963, at *10 (Del. Ch. Feb. 10, 2004) (determining that published historical tax rates were reliable); *Global GT LP v. Golden Telecom, Inc.*, 993 A.2d 497, 513 (Del. Ch. 2010) (adopting tax rate of 31%, which was based on predictions of management and company's historical tax rate), *aff'd* 11 A.3d 214 (Del. 2010); *Open MRI*, 898 A.2d at 313 (adopting tax rate of 29.4%); *Ng v. Heng Sang Realty Corp.*, 2004 WL 885590, at *6 (Del. Ch. Apr. 22, 2004) (adopting 11% tax rate), *aff'd* 867 A.2d 901 (Del. 2005); *Cannon*, 2015 WL 3819204, at *25 (adopting tax rate of 22.71%).

¹³⁶ *Gray v. Cytokine Pharmasciences, Inc.*, 2002 WL 853549, at *8 (Del. Ch. Apr. 25, 2002) (disregarding expert's unsupported adjustments to management's projections).

Dell’s proffered tax expert, Professor Shay, offers no basis to believe that a 35.8% tax rate will ever reflect Dell’s “operative reality,” but merely posits that the use of the highest marginal rate here is “consistent with the decision of the Chancery Court in [*In re Appraisal of Ancestry.com*].”¹³⁷ In *Ancestry*,¹³⁸ Vice Chancellor Glasscock favored application of a marginal tax rate “because of the transitory nature of tax deductions and credits.” But *Ancestry* did not involve overseas income. Thus, even crediting the supposed “transitory nature” of deductions and credits in the United States, such rationale has no application to Dell’s worldwide operations. More importantly, however, the evidence in *Ancestry* indicated that the marginal tax rate *was the company’s historical effective tax rate*.¹³⁹ So *Ancestry*, in fact, is consistent with well-established Delaware precedent supporting application of a company’s historical tax rate in a DCF analysis.

¹³⁷ Shay Rpt. ¶42.

¹³⁸ 2015 WL 399726 (Del. Ch. Jan. 30, 2015).

¹³⁹ *In re Appraisal of Ancestry.com*, 2014 WL 3752941 (Del. Ch. June 18, 2014) (Testimony of Respondent’s Expert Witness, Gregg Alan Jarrell, Ph.D., at 34-35: “I used 38 percent because it matched up with the company’s actual effective tax rate over the historical period that I have shown on Slide 73 from 2004 to 2012[]”; “I think 38 percent, to me, is more defensible here because it’s consistent with the company’s long-term historical average tax rate.”).

II. THE PROPER ADJUSTMENTS FOR EXCESS CASH TO THE DCF VALUATION OF DELL

Although similar in process, the differences discussed in the preceding sections lead Petitioners' expert to conclude that the result of a DCF valuation was \$25.15¹⁴⁰ and Respondent's expert to conclude that the value of Dell was \$14.76.¹⁴¹ Again, the parties' experts agree that Dell's net cash, adjusted for changes that were transaction related must be added to the DCF valuation. However, Petitioners believe that adding net cash increases the value of Dell whereas Respondent believes that adding net cash decreases the value of Dell.

Professors Hubbard and Cornell agree that if a firm has excess cash, it is a "valuable non-operating asset of the firm and should be added to the DCF

¹⁴⁰ Prof. Cornell concluded that the Enterprise Value of Dell using the BCG 50% Case was \$45,413M (Cornell Rpt. Ex. 10), and \$44,329M using the Bank Case with Cost Savings (Cornell Rpt. Ex. 11). With approximately 1,784M shares outstanding, this translates to \$25.45 per share under the BCG 50% Case, and \$24.86 under the Bank Case with Cost Savings. Weighted evenly, this results in a value of \$25.15 per share.

¹⁴¹ Hubbard Rpt. at Figure 38 (based on the BCG 25% Case). Hubbard further noted that the DCF value based on the Bank Case (which he cites for corroboration only) would be \$16.41. Hubbard Rpt. at Figure 40.

valuation.”¹⁴² At the time of the Transaction, Dell had \$11.04 billion in cash and cash equivalents,¹⁴³ almost all of which was located overseas.¹⁴⁴

Instead of simply subtracting Dell’s debt from its cash and cash equivalents to obtain net cash and adding net cash to the DCF value of Dell (as Professor Cornell did), Professor Hubbard created three new liabilities and subtracted those liabilities from net cash to create negative net cash. Thus, when Professor Hubbard adds net cash to the DCF value of Dell, Dell’s value decreases. The three liabilities Professor Hubbard created are: (1) duplicative working capital requirements; (2) deferred tax liabilities for offshore profits; and (3) contingent FIN 48 tax liabilities. None of those reductions in value has any support in fact, law or economic literature.

A. Because The Forecasts Already Model Working Capital To Be Funded From Operations, It Is Inappropriate To Deduct Working Capital Requirements From Dell’s Cash Balance At Closing

Although Professor Hubbard acknowledges that one must add excess cash to the DCF valuation to obtain an accurate equity value, he does not use Dell’s actual

¹⁴² Hubbard Rpt. ¶61.

¹⁴³ PTO ¶317; JX738.

¹⁴⁴ Sweet 104:10-18.

cash balance. Instead, he deducts from that cash balance *\$5 billion* – nearly *half* of Dell’s cash¹⁴⁵ – claiming that “Dell required approximately \$5 billion in cash to fund its ongoing operations,” based on the August 2013 Rating Agency Presentation.¹⁴⁶ This adjustment to Dell’s cash slashes Dell’s value by \$2.83 per share.

Professor Hubbard’s working capital adjustment is wrong. Dell’s operating cash needs were already accounted for in its working capital forecasts.¹⁴⁷ In fact, the BCG Case models contain an entire tab representing the working capital.¹⁴⁸ Both the BCG models and the Bank Case included the understanding that Dell’s operations were generating sufficient cash flow to fund themselves¹⁴⁹ and the

¹⁴⁵ Hubbard Rpt. ¶262.

¹⁴⁶ *Id.*

¹⁴⁷ Nicol 79:15-25 (recalling that “there was no assumption that access to out – out of the U.S. cash was necessary for the continuing operations of the company”); Sweet 251:17-20 (Dell’s working capital needs were baked into the company’s budgets and financial plans); Sweet 253:12-15 (Dell’s operating cash needs are included in the company’s working capital assumptions).

¹⁴⁸ JX932 (tab entitled “WC”).

¹⁴⁹ Sweet 264:18-265:10 (Bank Case model projected that Dell’s operations were going to be generating sufficient cash for the company to fund its operations without having to “keep reaching into their banking account to keep going”); Nicol 79:15-21.

Company had no history of, or need to, access its foreign cash to fund its operations.¹⁵⁰

Moreover, even if Dell's operating cash needs were *not* accounted for in its working capital forecasts, Professor Hubbard's deduction of \$5 billion is unsupported by the evidence. Dell's current CFO Tom Sweet testified that the \$5 billion figure used in the Bank Case included *restricted cash* that Dell could not actually use and that the Company's *actual liquid cash needs* were \$3.0-\$3.4 billion.¹⁵¹ Under these circumstances, the most that could legitimately be deducted from Dell's cash balance to account for working capital needs is \$3.4 billion, not the \$5 billion that Professor Hubbard deducted.¹⁵²

Even a \$3.4 billion deduction, however, would be improper here. Sweet testified that Dell has managed to get its liquid cash needs down to \$2.2-\$2.3 billion by implementing a number of working capital initiatives, each of which

¹⁵⁰ PTO ¶286; Sweet 271:1-22.

¹⁵¹ Sweet 246:2-14 (“[O]f that 5 to 5 and a half, some of that was restricted and therefore not available to use, but we thought we generally needed somewhere around 3 billion to 3.2 to 3.4 billion, in that range, of liquid cash”); Sweet 281:11-282:1 (Dell could not really use the restricted cash; actual cash it needed to run its business was around \$3.2 billion).

¹⁵² Silver Lake's LBO model is consistent. JX701 at SLP_DELLAP00073090 (listing \$3 billion in “cash required for working capital”).

Dell could have implemented as a public company.¹⁵³ Dell's actual liquid cash needs, therefore, were at most \$2.3 billion as of the date of the Transaction. Because Dell had access to a \$2 billion line of credit as of the Transaction,¹⁵⁴ there is simply no basis to deduct *any* amount of cash to account for working capital needs, let alone the outsized \$5 billion deduction made by Professor Hubbard.

In contrast to Professor Hubbard, Professor Cornell used the projections as they were prepared, which included forecasts for working capital needs. He therefore made no additional deduction from excess cash to fund "ongoing operations."

B. Professor Hubbard Creates Certain Tax Adjustments To Lower Dell's Value

Professor Hubbard, with Professor Shay's assistance, created two gigantic tax liabilities that he uses to eviscerate Dell's substantial cash balance and turn net cash into a reduction in value.

First, without any factual support, Hubbard claims that at the start of his terminal period (2023) Dell will begin to repatriate its overseas cash over a 25 year period. Hubbard further assumes that this repatriation will be done at the highest

¹⁵³ Sweet 276:13-281:6.

¹⁵⁴ Sweet 250:23-251:16.

marginal tax rate. He then takes the present value of all of these taxes and subtracts that value from the DCF valuation of Dell.

Second, Hubbard takes a financial accounting convention, FIN 48,¹⁵⁵ which instructs companies to create a reserve for tax contingencies that estimate the taxes that *might* be paid in the future should a taxing authority determine that a current tax position was improper, and uses it to manufacture an additional deduction from net cash.¹⁵⁶ In determining the amount of cash that needed to be added as a non-operating asset, Professor Hubbard deducted **\$3 billion** straight from Dell's cash to account for its FIN 48 liabilities.

Neither of these creations by Professors Hubbard and Shay is tied to any actual plans of Dell. Indeed, both are contrary to Dell's historical practices, and neither finds any support in Chancery precedent or in economic literature. And yet, Respondent uses these figments of its experts' imaginations to reduce the

¹⁵⁵ FIN48 refers to the Financial Accounting Standard Board FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes."

¹⁵⁶ Hubbard Rpt. ¶266.

value of Dell by almost \$3.00 per share.¹⁵⁷ “In determining fair value, this court cannot consider speculative tax liabilities.” *Heng Sang*, 2004 WL 885590, at *6.

1. The Idea That Dell Will Repatriate All Of Its Overseas Cash At a 35.8% Tax Rate Beginning In 2023 Is Fantasy

As of FY2013, Dell had approximately \$19 billion of earnings and profits that had been generated overseas for which foreign tax had been paid but U.S. tax had not.¹⁵⁸ Under APB 23, so long as Dell has a basis for saying that it intended to invest these earnings and profits overseas, these profits would be deemed “indefinitely reinvested” abroad and no U.S. tax would apply. Only when, and if, Dell repatriated these profits would any U.S. tax become due.

At the time of the Transaction, Dell had substantial opportunities to continue to reinvest its foreign earnings and profits overseas. A Dell second quarter 2013 Competitive and Industry Analysis noted that “Brazil, China, India, Russia and Mexico [were] all expected to have double-digit [year-over-year] IT spending growth in CY 12.”¹⁵⁹ During an October 4, 2012 Management Presentation, Dell reported that “[e]merging markets are expected to contribute an incremental \$60

¹⁵⁷ Hubbard Rpt., Figure 38 ((FIN 48 Liability = (\$1.71); Deferred Foreign Tax Liability = (\$1.25)).

¹⁵⁸ JX404.

¹⁵⁹ JX937 at 3.

billion in IT spend[ing] over the next four years.”¹⁶⁰ Dell planned as of the date of the Transaction to “[c]apitalize on the shift of geographic wealth to emerging countries”¹⁶¹ since the “BRIC countries [Brazil, Russia, India and China] [were] on pace to exceed the US GDP by 2015 and G7 GDP by 2023.”¹⁶² Beyond BRIC, “[a] new set of growth countries, N/11 [Bangladesh, Egypt, Indonesia, Iran, Mexico, Nigeria, Pakistan, Philippines, Turkey, South Korea and Vietnam] [were] on the same growth path.”¹⁶³ Further, the Asia-Pacific region was expected to house 54% of the world’s middle class by 2020.¹⁶⁴ As of the date of the Transaction, Dell had set its sights on capitalizing on the growth of these markets and continuing to expand its overseas operations.¹⁶⁵ As Dell stated in the Merger

Proxy:

The Parent Parties currently expect that, following the merger, the Company will make significant investments to enhance its presence and ability to compete in emerging markets, including the BRIC countries (i.e., Brazil, Russia, India and China). In addition, the

¹⁶⁰ JX161 at 20.

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ PTO ¶280; *Supra* n.129-130.

Parent Parties expect that the Company will expand aggressively in other parts of Asia, Latin and South America, Central and Eastern Europe, the Middle East and Africa.¹⁶⁶

Given Dell's substantial opportunities to invest overseas, as of the date of the Transaction the Company had *no plans* to repatriate *any* of its overseas cash for any reason other than to get the money it needed to close the Transaction.¹⁶⁷

Even if Dell were to repatriate any foreign profits, let alone all, it is without precedent that Dell would do so at the highest marginal rate.¹⁶⁸ In fact, Dell has *never* repatriated offshore cash under circumstances that would have required it to pay the full marginal rate.¹⁶⁹ To the contrary, Dell either waits for a tax holiday¹⁷⁰ or finds some other way to access its overseas cash for minimal, if any, taxes.¹⁷¹

¹⁶⁶ JX534.

¹⁶⁷ Sweet 122:14-123:2.

¹⁶⁸ PTO ¶283.

¹⁶⁹ Sweet 124:2-12.

¹⁷⁰ PTO ¶285; Sweet 126:13-128:2 (Dell repatriated substantial amounts of its offshore cash during the 2004 tax holiday; Dell did so not because it had operational needs for this cash but, rather, because it was cheap).

¹⁷¹ Sweet 129:22-130:3 (“Q: Other than the 2004 tax holiday, Dell has repatriated cash at different points, correct?; A: Yes, we have. Q: And when it’s done so, in each and every instance, it’s found some way to do it for less than the full 35 percent, right?; A: Yes, that’s correct.”); JX98 (detailing Dell’s ability to repatriate nearly \$9 billion in 2013 for \$0 in taxes); JX384 (detailing structures Dell has in place to allow tax-free repatriation).

There was no reason as of the Transaction date to believe this would change, as Dell retained an army of high-priced accountants and tax lawyers to ensure that it would continue to find ways to minimize its tax liabilities.¹⁷²

To accept Professor Shay's opinion that it is reasonable to assume that Dell will be forced to repatriate its offshore cash at the full federal marginal rate beginning in 2023, one must believe *all* of the following: (1) the 35% federal marginal tax rate will never come down during Dell's lifetime, whether by enactment of a tax holiday or the implementation of tax reform; (2) the various extant strategies for tax-free repatriation will all disappear; and (3) Dell will completely reverse course and decide, for the first time in its history, to begin repatriating cash in the year 2023 at the full marginal rate.¹⁷³ Such speculation is not permitted under established Delaware law.

In *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549 (Del. 2000), the Supreme Court held that the Court of Chancery improperly reduced the value of a corporation subject to appraisal by deducting speculative tax liabilities that would not have been incurred under the operational plans of the company at the time of

¹⁷² Sweet 47:4-14; 64:9-69:8.

¹⁷³ Steines Rpt. ¶14.

the sale.¹⁷⁴ The record is undisputed that Dell had *no plans to repatriate foreign cash*. For this reason alone, Professor Hubbard's deduction should be rejected. Deducting for this speculative tax liability caused Professor Hubbard to improperly reduce the per share equity value by \$1.25.¹⁷⁵

2. Using The FIN 48 Accounting Convention To Reduce The Value Of Dell Is Improper And Unprecedented.

Dell acknowledges that its effective tax rate from 2008 to 2012 was between 17.6% and 29.2%.¹⁷⁶ Over the last 10 years Dell's effective tax rate has been 23.8%.¹⁷⁷ Dell projects its effective tax rate going forward to be in the high teens.¹⁷⁸ The effective tax rate includes all taxes (actual, deferred or contingent)

¹⁷⁴ 747 A.2d at 552 (“The record reflects that a sale of its appreciated investment assets was not part of Okeechobee’s operative reality on the date of the merger. Therefore, the Court of Chancery should have excluded any deduction for the speculative future tax liabilities that were attributed by Alcoma to those untemplated sales.”).

¹⁷⁵ Cornell Reb. ¶73.

¹⁷⁶ JX393 at DELLE00611823.

¹⁷⁷ Cornell Reb. ¶36 and Ex.5.

¹⁷⁸ JX757 at 19, n.2 (“Tax at 17.0% per Company management.”)

that Dell pays each year.¹⁷⁹ Thus, reserves that might have been set aside under accounting conventions for contingent liabilities incurred in the past are economically taken into account as part of the projected tax rate in the future. Therefore, deducting FIN 48 reserves from a DCF valuation is effectively double counting, which might explain why no support for doing so exists in case law or academic literature.

Professor Hubbard admits that he is unaware of any other valuation of Dell in which FIN 48 liabilities had been deducted in calculating the Company's enterprise value.¹⁸⁰ Likewise, Professor Shay testified that he could not identify any valuation texts that specified that FIN 48 liabilities should be deducted from a company's value.¹⁸¹

Besides not being supported by case law or academic literature, Professor Hubbard's decision to deduct the full amount of Dell's FIN 48 reserves is unsupported by the facts. Neither Professor Hubbard nor anyone at Dell ever

¹⁷⁹ Sweet 58:4-13 (“effective tax rate” is the “tax rate that is presented in the financial statements of the company that takes pretax financial statement income and adjusts it for tax items to project an effective tax rate that’s – meaning you’re either going to pay taxes either currently or you’re going to defer some elements of those taxes within that rate”).

¹⁸⁰ Hubbard 309:9-12.

¹⁸¹ Shay 117:11-20.

conducted any analysis of Dell's history of having to pay taxes from its FIN 48 reserves or conducted any analysis of the individual tax positions of which Dell's FIN 48 reserve was comprised.¹⁸² In fact, Dell had no expectation that it would have to pay the full \$3 billion reserved under FIN 48 within the forecasted period. To the contrary, Dell expected that it would pay *at most* between \$650 and \$700 million of the FIN 48 reserves during the projection period.¹⁸³ Tellingly, a Houlihan Lokey valuation of Dell as of January 31, 2014 assumed that the sum total of all of Dell's *tax and legal* liabilities ranged from \$835 million to \$865

¹⁸² Sweet 203:10-205:33 (Sweet did not discuss with either Professor Hubbard or Professor Shay the composition of the FIN 48 reserves or any analysis of the likelihood of Dell having to pay with respect to any position of which that reserve was comprised).

¹⁸³ Sweet 213:15-24. *See also* JX165 at 20 ("Settlement of tax liability expected to be ~ \$0.6bn or less (lower than reserve of ~ \$2.5bn)").

million – a mere fraction of the \$3 billion FIN 48 reserve that Professor Hubbard has elected to deduct from Dell’s cash.¹⁸⁴

III. OTHER DIFFERENCES

A. Terminal Growth Rate

Both Professors Hubbard and Cornell agree that Dell was anticipated to have positive (or at least not negative) growth over the forecasted period.¹⁸⁵ Professor Cornell selected a conservative PGR range of 0.0% to 2.0%. Professor Cornell’s assumption that Dell would either (1) experience no growth going forward or (2) grow in perpetuity at a subinflation rate of 1%-2% is extremely conservative. *See, e.g., Global GT LP*, 993 A.2d at 511 (“A viable company should grow at least at the rate of inflation and ... the rate of inflation is the floor for a terminal value

¹⁸⁴ Dell did not determine the present value of any contingent tax liabilities that may be paid out of its FIN 48 reserves. This failure is significant because Tom Sweet acknowledged that deferring tax payments has a positive present-value impact on Dell and that many years might elapse from when Dell first booked a FIN 48 reserve for a given position until the time Dell might actually have to pay out on that item. Sweet 184:4-22; 191:15-193:15. Thus, even if there were facts from which a reasonable conclusion could be drawn that the full \$3 billion would ultimately be paid (and there are not), deducting the full \$3 billion would be improper, because it would fail to account for the very real value Dell would realize by deferring the payment of these taxes.

¹⁸⁵ Both experts arrived at their respective growth estimates using the Gordon Growth Method.

estimate for a solidly profitable company that does not have an identifiable risk of insolvency.”); *Prescott Grp. Small Cap, L.P. v. Coleman Co.*, 2004 WL 2059515, at *30 (Del. Ch. Sept. 8, 2004) (“What must be kept in mind that in computing a terminal value, only three growth assumptions are possible: (i) perpetual growth, (ii) perpetual stasis (no growth and no decline), and (iii) perpetual decline. To credit [respondent’s] position, this Court would have to conclude that after 2002, [respondent] would experience, in perpetuity, either no sales growth or negative sales growth. Such a finding could only be based upon accepting the Respondent’s portrayal of [the entity being valued] as a company on the brink of failure.”).

Any valuation methodology predicated on the assumption that Dell was going to “die” as a Company would not be reasonable. First, no one predicted that Dell was going to “die” as a company if it was not taken private.¹⁸⁶ Michael Dell and Dell management anticipated that the Company would positively grow cash

¹⁸⁶ Mandl 114:18-116:12.

flows in the future.¹⁸⁷ Second, Michael Dell and Silver Lake surely would not have been foolish enough to spend billions of dollars buying Dell if it was reasonable to assume that the Company had a negative perpetuity growth rate.¹⁸⁸ Third, Dell’s post-closing performance confirms that any assumption based on Dell having a negative PGR – even in its PC business – would be unreasonable. In interviews following the close of the Transaction, Michael Dell repeatedly highlighted the Company’s success, trumpeting “double-digit growth” and representing that “the business is strong.”¹⁸⁹ And in a presentation to rating

¹⁸⁷ Gladden 239:15-23 (“Q. Did you expect the company to lose money in the long-term? A. As a corporation? Q. Yes. A. In any given fiscal year or – Q. In the long-term – as an operating – as a going concern, as an operating entity. A. No.”); Gladden 49:14-50:14; 117:25-118:25; 184:5-17; 184:25-185:25; 234:15-22; and 235:15-22; Dell 96:16-97:15 (Michael Dell was “optimistic that [Dell] could grow cash flows over time”).

¹⁸⁸ Mandl 108:21-25 (Michael Dell and Silver Lake would not have spent billions of dollars to buy a company if they thought it was going to zero); Durban 222:10-224:15 (Bank Case was predicated on positive CAGR in both revenue and gross profits over the forecast period); Dell 465:15-17 (“Q: Did you buy Dell because you truly believed that Dell would be shrinking in perpetuity? A: No.”).

¹⁸⁹ JX748 (quoting Michael Dell speech at Dell World tech show during which he stated that Dell’s sales were up double digits and that the Company was “growing faster than the industry”); JX755 (“In an appearance on Charlie Rose last month, founder Michael Dell repeatedly said the PC manufacturer is seeing ‘double-digit growth.’”); JX834 (Michael Dell stated during an interview that “the kind of absolute returns in our business are healthy, so the business is strong.” and

agencies in April 2014, the Company highlighted that “Dell has successfully expanded share and grown amidst the backdrop of industry declines strengthening its scale.”¹⁹⁰ Under these circumstances, Professor Cornell’s selection of a 0% to 2% perpetuity growth rate is appropriate.

Professor Hubbard used a 2% PGR, a larger growth rate than Professor Cornell. However, Professor Hubbard’s growth rate must be seen within the context of his inclusion of the “transition period.” During that period, Professor Hubbard assumed significant additional investments thereby reducing free cash flow. These investment assumptions – untethered to any evidence – have the valuation effect as if Professor Hubbard used a growth rate significantly below 1%.¹⁹¹

B. WACC

Professors Hubbard and Cornell use different WACC assumptions. “WACC represents the investors’ opportunity cost of providing capital.”¹⁹² A company’s

admitted that the Company could pay down this debt because it had generated at least \$2.4 billion of free cash flow as of September 23, 2014); Dell 192:21-193:9.

¹⁹⁰ JX807 at DELLE00216713.

¹⁹¹ Cornell Reb. ¶20.

¹⁹² Hubbard Rpt. ¶226.

WACC is based on its cost of equity and debt financing, which are weighted to account for the company's capital structure. Dell routinely used an 8.5% WACC in conducting DCF analyses, both pre- and post-Transaction.¹⁹³ Further, an 8.5% WACC was "approximately in the same range as [the WACC of Dell's] peers:" HP, IBM, Cisco, and EMC.¹⁹⁴

Professor Hubbard used a 9.46% WACC¹⁹⁵ and Professor Cornell used a 9% WACC. This is not a significant difference, but it does lower Professor Hubbard's valuation calculation by \$0.57 - \$0.75 per share.¹⁹⁶ Professor Hubbard's WACC is larger as the result of his use of a higher estimate for Dell's equity risk premium. Professor Cornell used a 5.50% equity risk premium while Professor Hubbard used a 6.41% premium.¹⁹⁷ Professor Hubbard's equity risk premium is based on a long-

¹⁹³ Gladden testified that Dell "consistently" used an 8.5% WACC in conducting DCF analyses during his tenure at Dell. Gladden 43:11-21; JX718 (Thomas Luttrell of Dell treasury department references "our internal WACC assumptions, 8% to 8.5% pre- and post-LBO"). Professor Hubbard acknowledged that Dell continued to use an 8.5% WACC post-closing. Hubbard 109:17-24; JX789.

¹⁹⁴ Gladden 44:9-45:2.

¹⁹⁵ Hubbard Rpt. ¶257.

¹⁹⁶ Professor Hubbard's WACC accounts for a \$0.57 price difference when using the Hubbard Adjusted BCG Case, and a \$0.75 price difference when using the Hubbard Adjusted Bank Case. Cornell Reb. ¶80.

¹⁹⁷ Cornell Reb. ¶81.

run historical average of stock returns over treasury bonds from 1926 to 2012.¹⁹⁸ However, as explained fully in Professor Cornell’s Expert Report, research indicates that the forward-looking equity risk premium is significantly lower than the long-run historical average.¹⁹⁹ As a result, Professor Hubbard’s equity risk premium and, therefore, his WACC estimate, are improperly inflated.

IV. THE MARKET PRICE IS NOT A TRUE MEASURE OF DELL’S FAIR VALUE; THIS FACT IS NOT CHANGED BY THE GO-SHOP PROCESS

The Delaware Supreme Court has long recognized that the merger price – even if the merger price was obtained following a robust and “pristine” sales process – is not presumed to be equal to the going concern value. In *Golden Telecom, Inc. v. Global GT LP*, 11 A.3d 214 (Del. 2010), the Supreme Court refused to adopt a presumption that the merger price was entitled to deference in an appraisal action, stating:

Section 262(h) unambiguously calls upon the Court of Chancery to perform an independent evaluation of ‘fair value’ at the time of a transaction. It vests the Chancellor and Vice Chancellors with significant discretion to consider ‘all relevant factors’ and determine the going concern value of the underlying company. ***Requiring the Court of Chancery to defer — conclusively or presumptively — to***

¹⁹⁸ Cornell Reb. ¶82.

¹⁹⁹ Cornell Reb. ¶83.

the merger price, even in the face of a pristine, unchallenged transactional process, would contravene the unambiguous language of the statute and the reasoned holdings of our precedent. It would inappropriately shift the responsibility to determine ‘fair value’ from the court to the private parties. ... Therefore, we reject [respondent’s] contention that the Vice Chancellor erred by insufficiently deferring to the merger price, and ***we reject its call to establish a rule requiring the Court of Chancery to defer to the merger price in any appraisal proceeding.***

Id. at 217-18 (emphasis added); *see also Orchard Enters.*, 2012 WL 2923305, at *5 (“Orchard makes some rhetorical hay out of its search for other buyers. But this is an appraisal action, not a fiduciary duty case, and although I have little reason to doubt Orchard’s assertion that no buyer was willing to pay Dimensional \$25 million for the preferred stock and an attractive price for Orchard’s common stock in 2009, an appraisal must be focused on Orchard’s going concern value.”). Accordingly, there is no presumption that the \$13.75 merger price reflects the value of Dell as a going concern.

A. Dell's Management Recognized That The Company Was Undervalued

Both Dell management²⁰⁰ and advisors to the Company²⁰¹ and the Special Committee²⁰² steadfastly maintained that *the market price did not reflect Dell's true value*. BCG's analysis showed that *the market was valuing Dell as if it would have no free cash flows at all after 3.2 years*.²⁰³ Despite the concerns expressed by both Dell management and the advisors about a disconnect between the market price of Dell and its true value, the Proxy makes clear that the Special Committee did not seek to determine the value of Dell as a going concern:

The Special Committee did not seek to determine a pre-merger going concern value for the Common Stock to determine the fairness of the merger consideration to the Company's unaffiliated stockholders.²⁰⁴

²⁰⁰ JX532 at 27 (Gladden presented view “regarding the disparity between the Company’s public market valuation and his beliefs about the Company’s potential future performance”).

²⁰¹ *Supra* n.24; JX172 at DELLE00302211; JX170 at DELL00002462.

²⁰² *Supra* n.25; JX230 at DELLE00302229.

²⁰³ JX344 at DELL00002252 (“At consensus profitability, [Dell] will generate its own market cap in free cash flow in 3.2 years ... with zero terminal value implied.”). BCG admitted during its deposition that this meant that the market was valuing Dell as if it would have no cash flows at all after 3.2 years. Ning 111:7-18 (“Q: So the market-based projections would imply that the company will have no cash flows after 3.2 years, right? A: Logically, yes.”).

²⁰⁴ PTO ¶133; JX532 at 60 (emphasis added).

The irrationality of relying on the deal price as a proxy for fair value is laid bare by the admissions of both Michael Dell and Silver Lake that they *made no attempt whatsoever* to determine Dell’s intrinsic value in respectively agreeing to participate in²⁰⁵ and formulating²⁰⁶ the various offers that lead to the eventual \$13.75 deal price. Under these circumstances, there is no reason to assume that the deal price reflects the “true value” of Dell as a going concern.

The price that Silver Lake offered (and that Dell accepted) was *not* based on what Dell was worth as a going concern but, rather, was the result of a financial engineering exercise by which Silver Lake endeavored to figure out what it could pay for Dell while still hitting an acceptable rate of return. Under these circumstances, deference to the merger price would be entirely inappropriate.

²⁰⁵ Dell 9:21-10:21 (Silver Lake did not tell Michael Dell what they thought the company was worth or what return they expected Michael Dell could make on his investment); 11:25-12:5 (Michael Dell did not have a value or range of values of what he thought Dell was worth at the time he began thinking about taking the company private); 16:1-17:3 (Silver Lake never explained to Michael Dell what they were offering and why); 20:1-4 (Silver Lake never gave Michael Dell any information about how they determined what to offer for Dell).

²⁰⁶ Durban 10:10-13; 20:22-23:25; 67:1-67:16; 67:17-68:18; 72:4-72:21.

B. The Lack Of A Topping Bid Does Not Militate In Favor Of Deferring To The Deal Price

Nor does the lack of a topping bid militate in favor of deferring to the deal price. As set forth at length in the Subramanian Report, a number of institutional details and practical realities surrounding the Transaction rendered it highly unlikely that any topping bid would emerge, even if the deal price vastly undervalued Dell. Professor Subramanian found that in MBOs in general – and the Dell MBO in particular – four features exist that inhibit topping bids from emerging.

First, Michael Dell was a “net buyer” in the Transaction. As a result, he had an incentive to push the deal price down, not up.²⁰⁷ Any third party bid that was structured to include Michael Dell as a net buyer would cost Mr. Dell more money relative to his deal with Silver Lake – a fact that any potential bidder would well understand would make Michael Dell a reluctant partner in their bid.²⁰⁸

Second, informational asymmetries necessarily exist when an outsider seeks to bid against management.²⁰⁹ In the case of the Dell MBO, Professor Subramanian

²⁰⁷ Subramanian Rpt. ¶107.

²⁰⁸ Subramanian Rpt. ¶108.

²⁰⁹ Subramanian Rpt. ¶¶38-42.

observed that the informational asymmetry problem was particularly acute. Indeed, go shop bidders were not given access to the electronic data room until February 2013 – mere weeks before the March 23, 2013 go shop expiration period – whereas Silver Lake had access to this data room beginning in early September 2012.²¹⁰ Moreover, potential strategic suitors were not given access to the same information as financial sponsors.²¹¹ Further, Professor Subramanian found that certain parties who emerged during the go shop did not appear to have equal access to Michael Dell and other senior Dell management, whereas others (namely, Southeastern) had no access to Michael Dell *at all*.²¹²

Third, the go shop period was a mere forty-five days, which Professor Subramanian found was insufficient to allow potential bidders to (1) complete due diligence on a company as large and complex as Dell and (2) put together the consortium that would likely be needed to bid for a company as large as Dell.²¹³ Moreover, by not allowing any pre-signing competition, the Special Committee placed any competing bidders in the untenable position of having to go from “0 to

²¹⁰ Subramanian Rpt. ¶¶84.

²¹¹ PTO ¶187.

²¹² Subramanian Rpt. ¶¶85-86.

²¹³ Subramanian Rpt. ¶¶89-99.

60” entirely within the 45 day go-shop window.²¹⁴ Moreover, the presence of a supposed one-time match right did nothing to alleviate the pressures on potential alternative suitors because there was nothing to prohibit Michael Dell and Silver Lake from demanding another match right in exchange for a higher bid, essentially making the match right unlimited.²¹⁵

Fourth, Dell is simply “worth more” with Michael Dell than without him. Michael Dell chose to partner with Silver Lake, and all potential bidders knew this. Because Michael Dell had chosen to team up with Silver Lake – and was not contractually required to work with anyone else – the “valuable management” problem made it much more unlikely that a topping bid would emerge.²¹⁶

²¹⁴ Subramanian Rpt. ¶97.

²¹⁵ Subramanian Rpt. ¶¶114-115.

²¹⁶ Subramanian Rpt. ¶¶100-104.

CONCLUSION

Petitioners are entitled to the fair value of Dell as of the date of the Transaction, which is \$28.61, plus interest at the statutory rate.

Respectfully submitted,

Dated: September 28, 2015

/s/ Stuart M. Grant _____

Stuart M. Grant (# 2526)

Michael J. Barry (# 4368)

Christine M. Mackintosh (# 5085)

GRANT & EISENHOFER P.A.

123 Justison Street

Wilmington, DE 19801

(302) 622-7000

Counsel for Petitioners