EFiled: Oct 05 2015 02:49PM EDT
Transaction ID 57963049
Case No. 9322-VCL

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

Page(s)

Cases

Other Authorities

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. __"
Export 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 plan[5] 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] [redacted]

> ***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]

[redacted][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. [redacted][17] Dell stock at this time was trading around $14 – a substantial discount.

[15] JX530 at DELLE00238240.

[16] [redacted]

[17] JX44 at DELLE00148383.

[redacted].[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.

[redacted]

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] [redacted]

[25] [redacted]

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 [redacted] 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] [redacted]. [32]

On October 9, 2012, JPMorgan presented its first DCF analysis to the Special Committee. [redacted]. [34] Dell's stock, however, was trading at $9.66.[35] [redacted]. [36]

JPMorgan also produced an illustrative LBO analysis.[37] [redacted]

[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.

[redacted][38] [redacted]

[redacted]

[redacted].[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] [redacted]

[redacted]

[redacted]

[38] [redacted].

[40] Rajkovic 134:11-135:13.

[41] JX532 at 27.

[redacted]

t.[46]

[42] PTO ¶132; Durban 67:1-68:18.

[43] Durban 68:19-22.

[44] Durban 13:17-14:1.

[45] [redacted]

[46] [redacted]

* * *

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"); [redacted]).

[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 advisors[51] – 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); [redacted]

[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. [redacted].[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. [redacted]

[64] [redacted]

[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).

[redacted][67] [redacted]

[redacted].”[69]

[redacted]

[67] [redacted]

[68] JX669 at DELLE00779577.

[69] Dell 299:19-300:1.

[70] JX743.

[redacted] [redacted].[71] [redacted] [redacted]”[73]

[redacted] ***First***, the BCG Cases were meant to assess Dell’s long-term earning power. [redacted].[74] [redacted]

---

[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] [redacted]

[redacted].[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

[redacted]

75 [redacted]

76 [redacted]

77 [redacted]

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. [redacted]

[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] [redacted]

[redacted].[81] The Bank Case initially was prepared in January 2013, subsequently revised in August 2013, and presented to investors in September 2013. [redacted].„[82]

The Bank Case, as revised, was the set of projections created most closely in time to the Transaction. [redacted].[83]

[80] [redacted]

[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. [redacted][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. [redacted] 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. [redacted].[86] [redacted].[87] Petitioner's expert, Professor Bradford Cornell, included tho 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, [redacted]

[86] PTO ¶278; JX293 at SLP_DELLAP00116629

[87] JX679 at DELLE00238978, DELLE00239047

[redacted]. 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, [redacted][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] [redacted]

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"). [redacted]. 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. [redacted].[99] Professor Hubbard's adjustment is precisely the type of litigation-driven modification that this Court rejects.[100]

[redacted].[101] The August 2013 IDC forecast reflected the belief that the market outlook for desktop and notebook PCs

[97] Hubbard Rpt. ¶192.

[98] [redacted]

[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 – [redacted].[102]

[redacted].

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). [redacted]

[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 be 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 <u>any</u> 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.

[redacted].[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

[redacted]

[redacted]

[redacted]

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 rate[135] 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 $25.15[140] 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] [redacted]

[redacted].[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. [redacted].[146] This adjustment to Dell's cash slashes Dell's value by $2.83 per share.

Professor Hubbard's working capital adjustment is wrong. [redacted].[147] In fact, the BCG Case models contain an entire tab representing the working capital.[148] [redacted]

[145] Hubbard Rpt. ¶262.

[146] *Id.*

[147] [redacted]

[148] JX932 (tab entitled "WC").

[149] [redacted]

[redacted]

[redacted] [150]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted] [152]

[redacted]

[redacted]

[redacted]

[150] PTO ¶286; Sweet 271:1-22.

[151] [redacted]

[152] [redacted]

[redacted].

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 [redacted] 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 [redacted] 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 holiday[170] 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] [redacted]

[171] [redacted]

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] [redacted][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 uncontemplated 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] [redacted]

[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] [redacted]

[redacted][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] [redacted]

[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] [redacted]

[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

[redacted][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. [redacted].[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% WACC[195] 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] [redacted]

[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 management[200] and advisors to the Company[201] and the Special Committee[202] 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 was it if 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).

[redacted] 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] [redacted]

[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

EFiled: Oct 05 2015 02:49PM EDT
Transaction ID 57963049
Case No. 9322-VCL

CERTIFICATE OF SERVICE

I, Christine M. Mackintosh, hereby certify that on October 5, 2015, the *Public [Redacted] Version of Petitioners' Pre-Trial Brief* was filed and served via File & Serve*Xpress* 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)