

“going to Dell in a handbasket?”

“I am a better investor because I am a businessman and a better businessman because I am an investor. Can you really explain to a fish what it’s like to walk on land?”

One day on land is worth a thousand years of talking about it, and one day running a business has exactly the same kind of value.”

Warren Buffett

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Share price has declined from \$55 to \$12

Dell Inc. (DELL) - NasdaqGS

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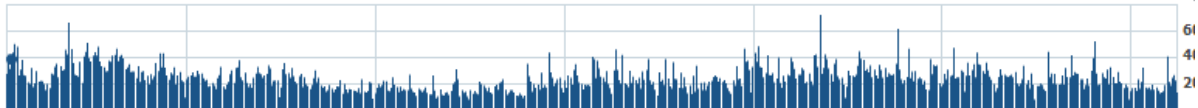
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Week of 21 Feb 2000: ■ DELL 41.25



■ Volume: 38,260,552



[1D](#) | [5D](#) | [1M](#) | [3M](#) | [6M](#) | [YTD](#) | [1Y](#) | [2Y](#) | [5Y](#) | [Max](#)

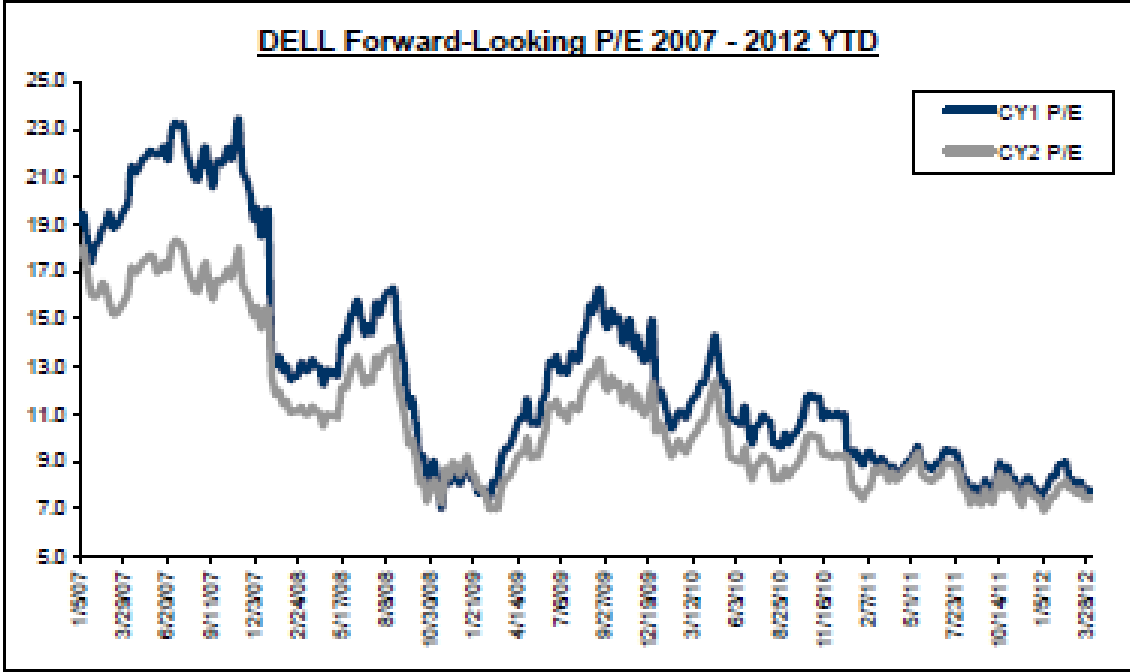
FROM: 31/1/2000

TO: 27/7/2012

-67.82%

Significant PE compression (was over 150 in 2000)...

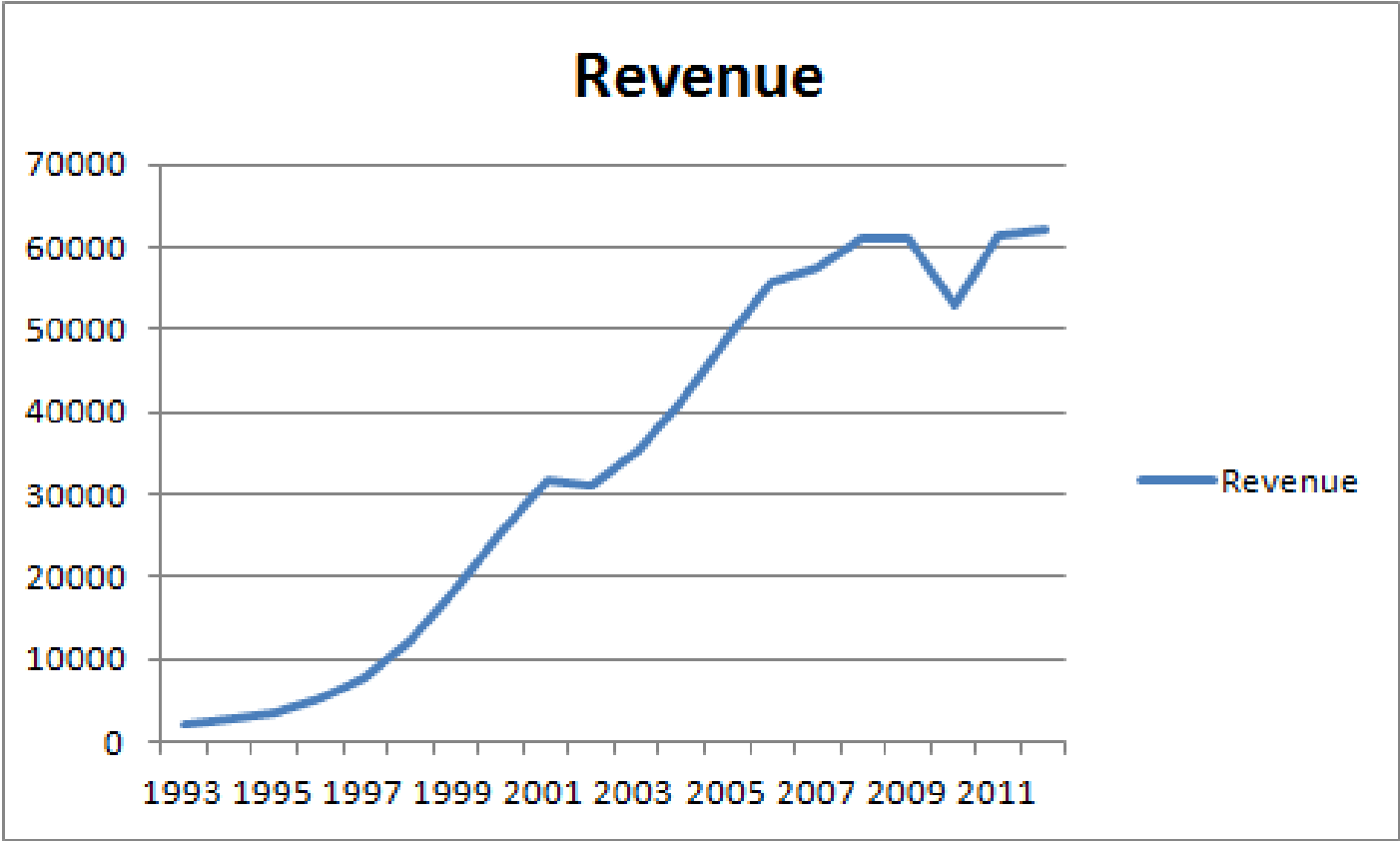
Exhibit 14
Dell trading near historical P/E lows



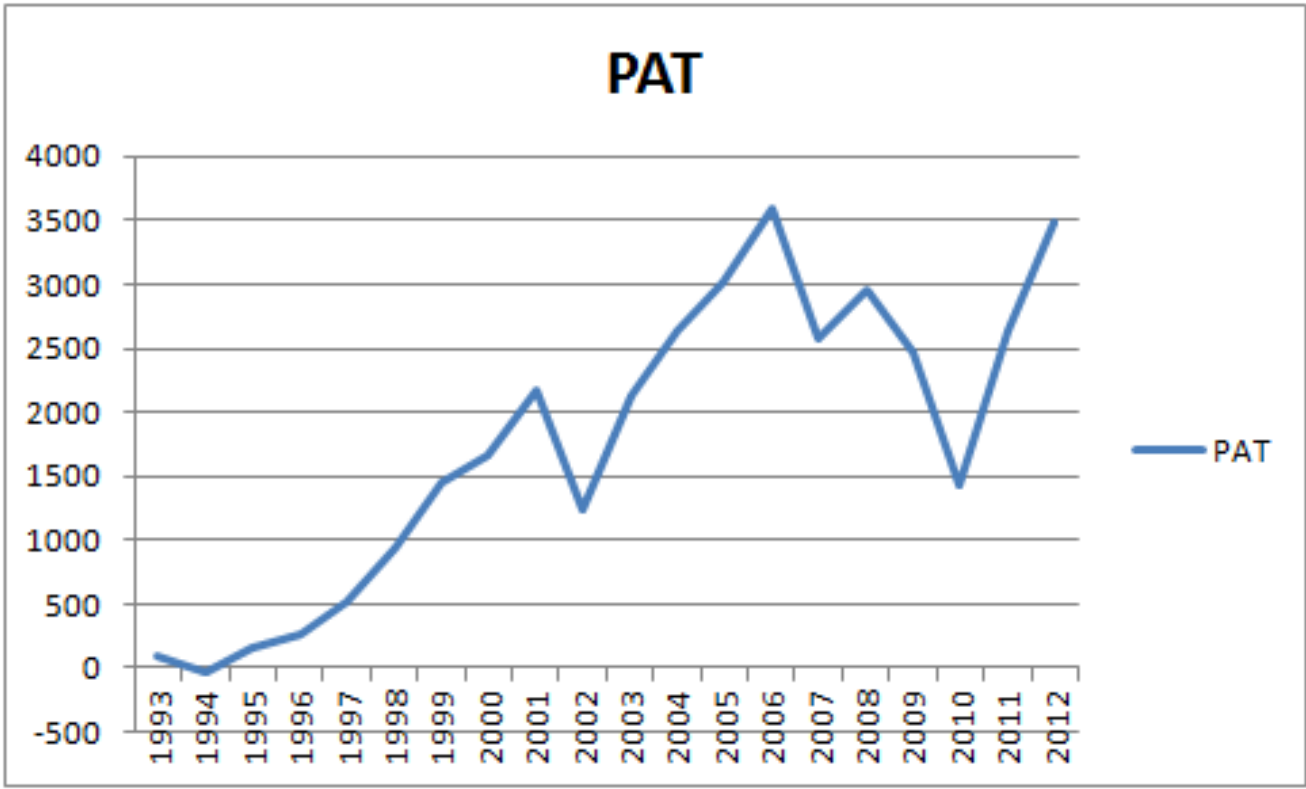
Note: CY1 is current calendar year and CY2 is next calendar year, so currently CY1 is CY12 and CY2 is CY13.

Source: Morgan Stanley Research and Thomson Reuters

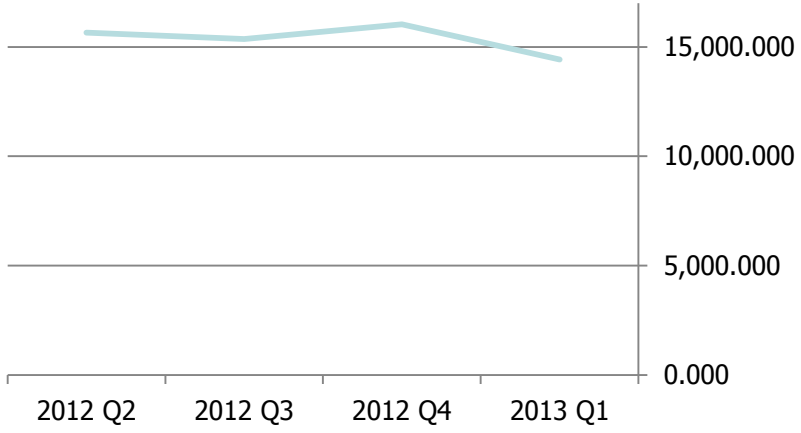
Revenue growth has flattened...



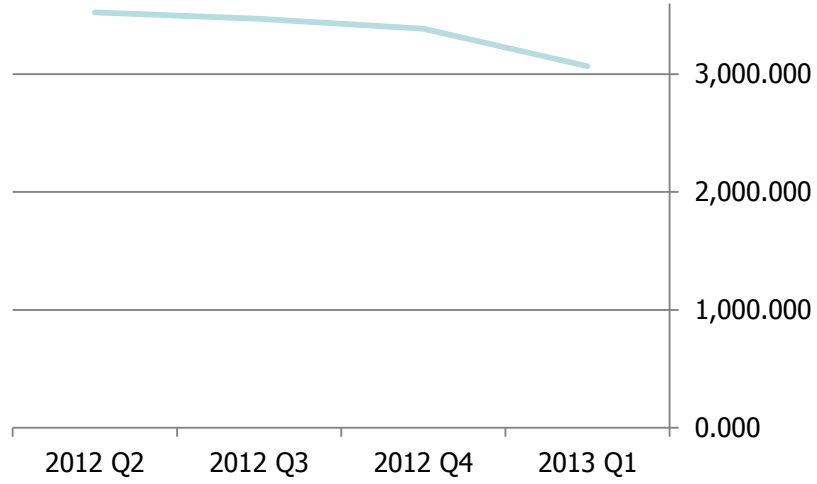
Profit has had a bumpier ride lately...



Recent news also negative:
Revenues falling Q on Q



and Gross Profit declining faster...



This is all about the rise of Apple and the demise of PCs isn't it?

"Dell shares dive, analyst points to 'Apple effect'"

"Beleaguered Dell blames Apple and weak demand for putrid Q1 results"

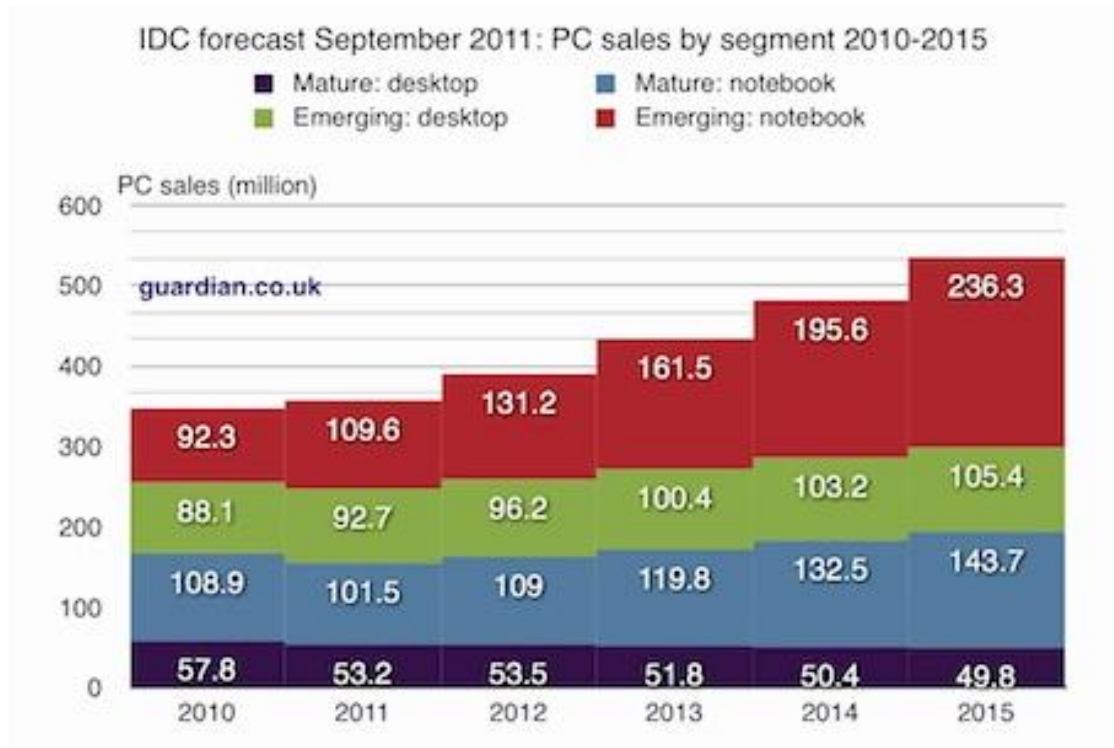
"Dell Falls Most Since 2000 After Missing Estimates on PCs"

"Dell revenues hit by growth of tablets"

Dell myths...

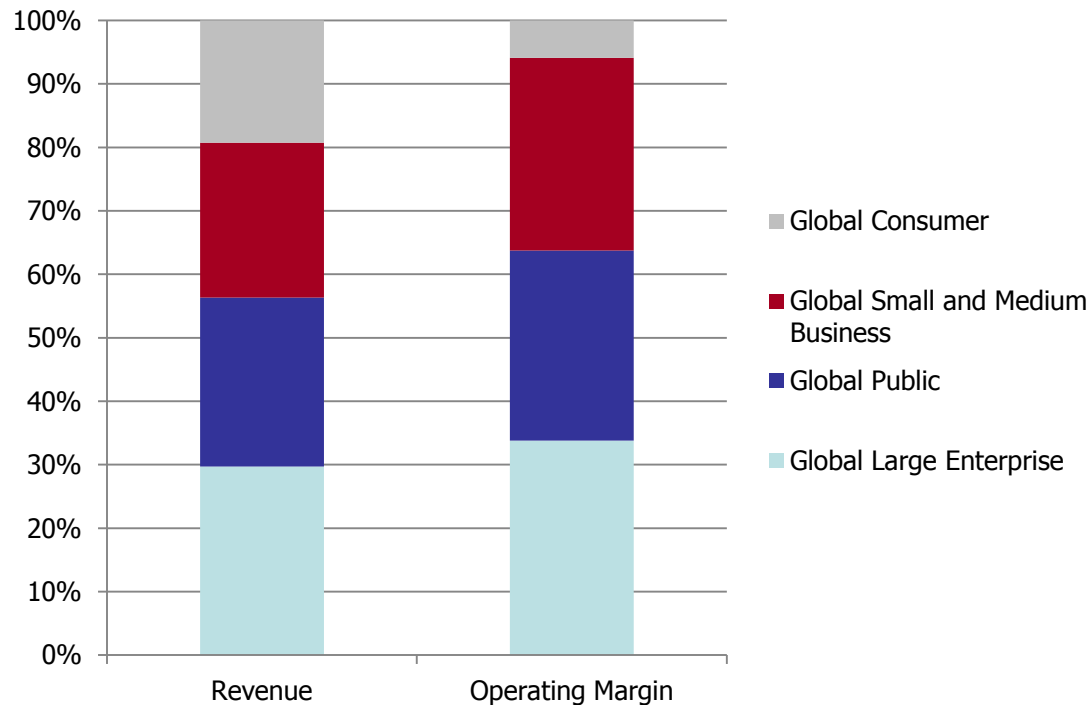
1. PCs are being replaced by tablets
2. Dell earns 1% operating margins on its PCs
3. The entire PC / Laptop business is a massively competitive commoditised business suffering from shrinking margins and over competition.
4. Dell is misallocating capital allocation to diversify away from its shrinking PC business

Dell myths...1. PCs are being replaced by tablets



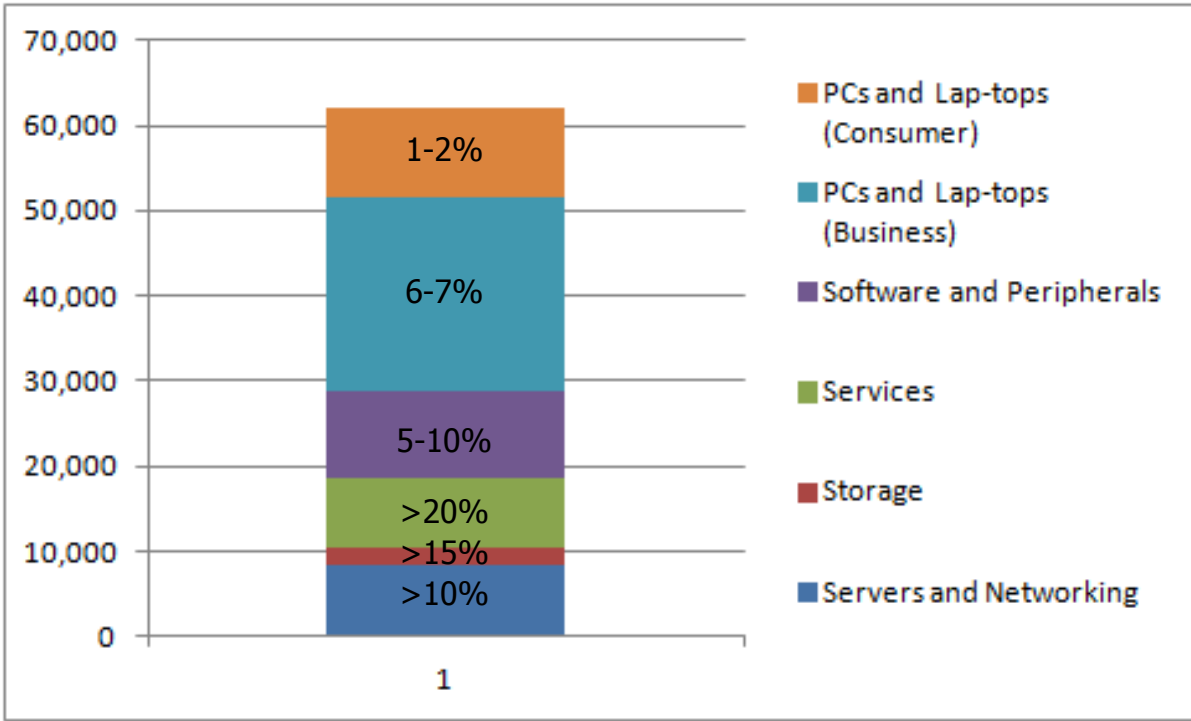
- PCs are expected to continue to grow but at a much slower pace than tablets
- Even the CEO of Apple recognises that the tablet and the PC serve a different function: "A fridge and a toaster".
- Huge legacy of investment in applications for PCs within the enterprise

Dell myths...2. Dell earns 1% operating margins on its PCs



Selling PCs to consumers : very low margin business (1-3%)...
but the consumer is not an important part of the Dell story: just 2-5% of profits

Dell myths...2. Dell earns 1% operating margins on its PCs



Dell: We can “continue to earn c5% operating margins on end user computing”, i.e. PCs and Lap-tops

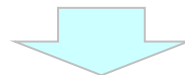
Dell myths...3. The PC / Laptop business is massively competitive and commoditised business suffering shrinking margins and over competition

"HP and Dell are the only game in town" IT Reseller

"Dell and HP are the only option because of their performance reliability and support" Manager of an IT services company

"If I proposed Acer or Lenovo to my clients, they would think I was mad"
Manager of an IT services company

"Its important to the enterprise that they have a one stop shop for PCs and servers with a very strong service support – only HP and Dell offer this"
Senior IT Consultant



PCs to businesses is a solid cash generator.

PCs are too important to employee productivity and relatively low cost for most IT Managers to want to switch from the main 2 suppliers on price – TCO, service and quality are more important decision drivers.

Dell myths...4. Dell is misallocating capital allocation to diversify away from its shrinking PC business

- We modelled scenario where Dell spends all cash and all next 5 years of cashflow on acquisitions at 30 times EBITDA - no synergies, no growth
→ Still a 40+% margin of safety in our model

Actually:

- Targets 15% IRR hurdle for acquisitions. Claims to achieve this on acquisitions since 2008. Equal Logic grew 4 times in the first 2 years of owning it 07-09.
- Dell has institutionalised ROIC as a measure for each business since the early 90s. It has been a key driver of decisions to scale back in certain customer segments and focus on others.
- Committed to return 20-35% of its FCF back to shareholders: 5-9% yield.

Dell myths...4. Dell is misallocating capital allocation to diversify away from its shrinking PC business

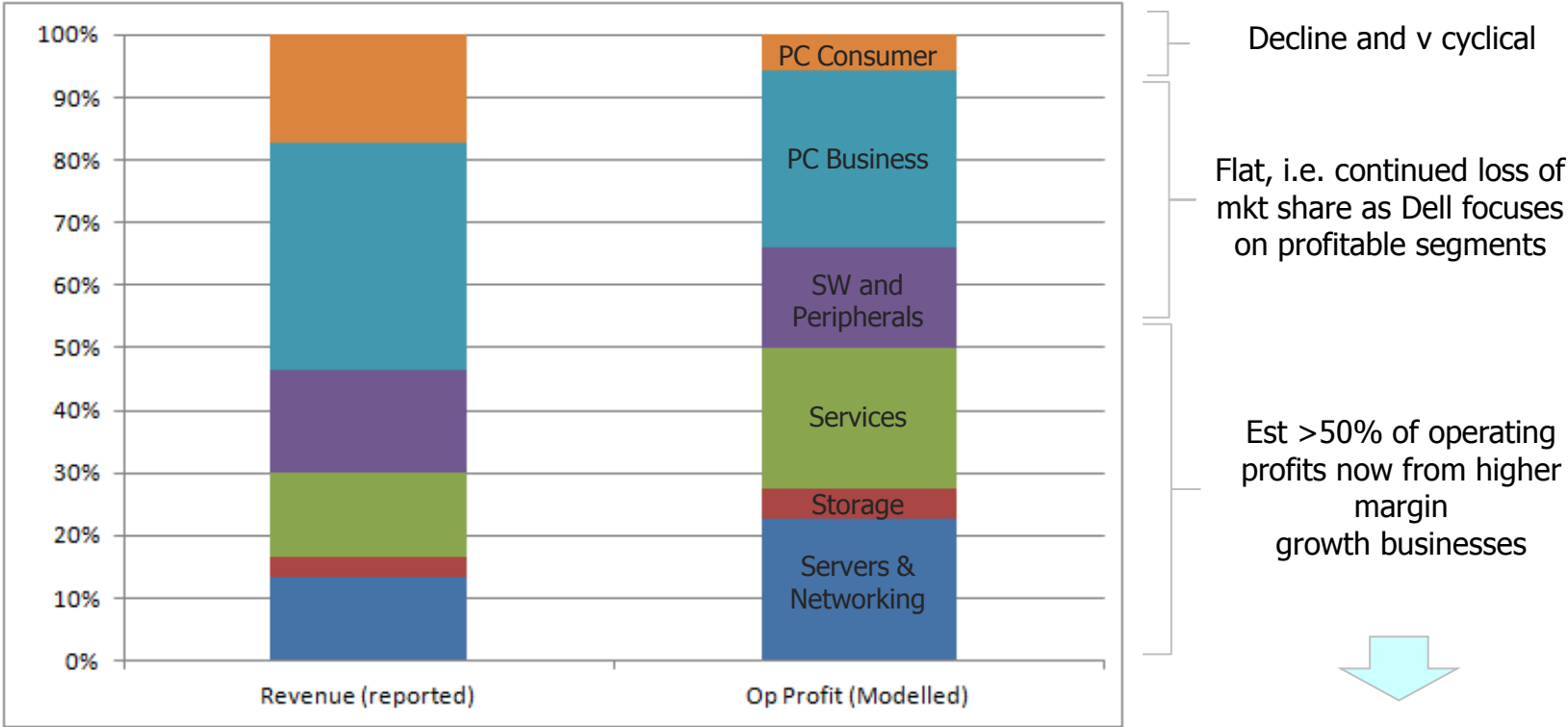
Michael Dell's family office's Public Equity Group:

- "We make long-term equity investments in a limited number of outstanding companies"
- "We employ a disciplined, research-intensive analytic process in searching for businesses that possess sustainable long-term competitive advantages and are managed by honest, astute and shareholder-minded management teams."
- "We firmly believe that businesses create wealth for their owners through the long-term generation of net free cash flow."
- "Although we typically invest as a minority owner of publicly-traded companies, given the long-term perspective that we take when we make investments, we consider ourselves to be a partial owner of the businesses in which we invest."
- "We focus on the absolute value of businesses, not their value relative to other "peer" companies or general stock market indices."

What else we like...

- Entrepreneur-led : with a 14% stake in the business, low ego.
- Culture of customer focus
- Direct customer relationship – competitive edge
- Clear focused strategy, building out from its core.
- Low overheads to gross profit – can sustain a 35% revenue shock before going cashflow negative.
- Cashflow almost always higher than profits (missed one year in the last 10)
- Detailed data driven management style which focuses on ROIC as the core measurement.

Dell's higher margin growth businesses should compensate for any decline in the core...



Assume no growth

Source: Dell accounts and Metropolis Capital analysis

Priced to fail...

	2013	2014	2015	2016	2017
2013 Post Tax CF	4.5	4.5	4.5	4.5	4.5
Total Buyback	0.64	0.64	0.64	0.64	0.64
Market Cap	22.2	21.56	20.92	20.29	19.65
Total Dividend	0.60	0.60	0.60	0.60	0.60
Net Cash	4.6	7.9	11.1	14.4	17.7
EV	17.6	13.7	9.8	5.9	2.0
EV : FCF	3.9	3.0	2.2	1.3	0.4
Dividend yield	2.7%	2.8%	2.9%	3.0%	3.1%

NB – hypothetical model which assumes no new acquisitions

*Normalised CF removes the benefit of the deferred revenue and assumes tax at 32%

Priced to fail...

	2013	2014	2015	2016	2017
2013 Post Tax CF	3.5	3.5	3.5	3.5	3.5
Total Buyback	0.36	0.36	0.36	0.36	0.36
Market Cap	22.2	21.84	21.47	21.11	20.75
Total Dividend	0.60	0.60	0.60	0.60	0.60
Net Cash	4.6	7.1	9.7	12.2	14.8
EV	17.6	14.7	11.8	8.9	6.0
EV : FCF	5.0	4.2	3.4	2.5	1.7
Dividend yield	2.7%	2.7%	2.8%	2.8%	2.9%

NB – hypothetical model which assumes no new acquisitions

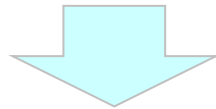
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Where are the risks...

- Reliance on Michael Dell at the helm.
- Business world moves IT rapidly to large cloud operators like Amazon
- Lenovo starts gaining acceptance as a 3rd hardware provider to Western businesses.
- Unsuccessful acquisitions and/or unsuccessful integration of multiple acquisitions

In summary...

- A core cash generative business which has a commanding position within its niche of providing IT hardware to businesses
- Growing base of higher margin products and services into the same customers.
- Led by a true entrepreneur founder with 14% ownership and a high focus on long-term shareholder returns
- Institutionalised capital allocation disciplines which have driven a historic track record of delivering the most efficient and lowest cost products and services in its sector.



At 4-6 times FCF: “One Dell of an investment opportunity”

Book recommendation...

"How Dell does it": Steven Holzner (1 Jan 2006)