Case Study Instructions

Stop the presses! Before reading Longleaf's valuation of Dell, go to the 2009 and 2013 Value-lines and value Dell with a back of the envelope calculation using a post-tax free cash flow yield as one signpost.

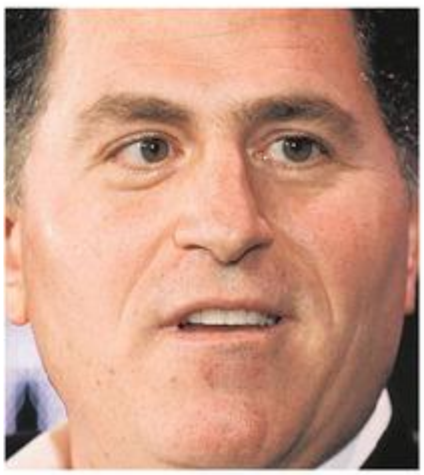
What do you think Dell is worth—about? What do you think of the valuations mentioned in this article? Does growth have value? What aspects of Longleaf's letter put heat on M. Dell? What might you add?

Do you have any criticisms? What in Michael Dell's prior history makes you (perhaps) not surprised by his current actions. Should Dell offer to do a Tender Offer? SATURDAY, FEBRUARY 9, 2013

The Dell Deal May Die www.barrons.com

Under Fire

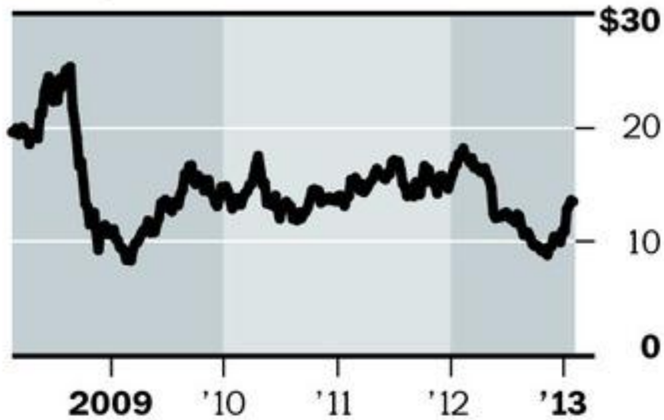
Michael Dell probably figured that investors would go along with the $24.4 billion leveraged buyout of his company. He was wrong.



Michael Dell

Dell (DELL - Nasdaq)

Weekly close on Feb. 7



Source: Thomson Reuters

DELL KEY DATA	
Recent Price	$13.63
52-Week Change	-24%
2012 EPS*	$1.71
2013 EPS**	$1.67
2013 P/E	8.0
Market Value	$23.6 billion
Net Cash	$5.2 billion

*Year ended Jan. 2013. **Year ends Jan. 2014.

DELL BUYOUT	
Initial Equity	$5.85 billion
New Debt	$15.75 billion
Five Years Later	
New Debt	Zero
Equity Value	$21 billion
Annualized Return	29%

Source: Thomson Reuters

By ANDREW BARY | MORE ARTICLES BY AUTHOR

Shareholders are being pushed aside in the proposed Dell buyout. The big winner? Michael Dell, whose $3.7 billion stake could more than triple that in five years. But the company's biggest outside investor opposes the deal.

Article

Michael Dell's deal to take his namesake company private initially was treated as a near certainty on Wall Street. But there's a reasonable chance that shareholder resistance will scuttle the transaction. The company's leading outside shareholder, Southeastern Asset Management, said Friday that it plans to oppose the deal, which it says "grossly undervalues the company."

The Southeastern position could galvanize Dell holders, many of whom are unhappy with the low price that Michael Dell plans to pay. Southeastern, which holds an 8.5% stake, said it plans to "avail itself of all options" to kill the deal.

It's possible that Michael Dell could sweeten his offer, but the increase would have to be hefty, given that Southeastern believes **Dell is worth $24 a share**.

Tony Avelar/Bloomberg

The $24.4 billion buyout of Dell (ticker: DELL) announced last week would pay stockholders $13.65 a share. That amounts to just eight times projected 2013 profit of $1.67 a share and just six times earnings, excluding Dell's net cash of $5 billion, which comes to $3 a share. That's a steal, given that Dell is believed to have earned $1.71 a share in its just-concluded fiscal year that ended in January. No major company has ever gone private so cheaply. Most leveraged buyouts are done for double the Dell transaction valuation.

"This deal is so compellingly unfair to shareholders that I don't know where to begin," says Richard Pzena, chief investment officer at Pzena Investment Management, which held 14 million shares on Sept. 30. His firm values Dell at about $25 a share. The stock was unchanged at $13.63 last week, after gaining about 1% Friday afternoon on the Southeastern news.

Look for Michael Dell and his investment bankers to put out the word that rejection of the deal would hammer the stock price back down toward its 2012 low of $9. Such a drop is very unlikely. The initial decline could be just a point if the buyout is withdrawn, and the shares could rise if the company makes a tender offer for its stock.

Barron's wrote last month that founder and CEO Michael Dell, who owns 16% of the shares, was looking to steal the company at the then-rumored price of $14. The actual offer was even lower, and $4 below where Dell traded just a year ago. **We suggested that a fairer approach would be for Dell to make a $10 billion tender offer for its stock at $15, retiring nearly 40% of its shares and allowing holders who choose to hang on to benefit ("How to Give Dell's Shareholders a Fair Deal," Jan. 21).**

INITIALLY, IT LOOKED as if Michael Dell had the upper hand, because it's hard to mobilize a large group of shareholders to oppose any buyout. Index funds usually back takeovers, as do risk arbitrageurs, who likely were heavy buyers of Dell stock last week. But Southeastern's opposition has changed the calculus. The deal requires approval by a majority of shareholders, excluding Michael Dell.

"This is a hard deal to get done at this price. There will be resistance," says Don Yacktman, head of the Yacktman Funds, which held nearly 15 million shares on Sept. 30. He declined to say how he plans to vote. It's possible, too, that a prominent activist investor like Bill Ackman, Carl Icahn, or Dan Loeb could take a stake in Dell and oppose the buyout, which is slated to close around midyear.

THE STANDARD RATIONALE for the low price is that Dell's personal-computer business, which generates half its sales, is in terminal decline. But Pzena says that pessimistic view is at odds with the bullish scenario that Michael Dell laid out last June at the company's annual analyst day. Dell said the company's goal was to generate $74 billion of revenue and $6 billion of operating profit in 2015, up from an estimated $56 billion in sales and $4 billion in operating profit in the just-ended fiscal year. The gains would be driven largely by the company's growing software-and-services business. Dell has made about $13 billion of acquisitions in these areas since 2008.

"Given that presentation, it's a travesty that the Dell board considered the price to be fair," Pzena says. It's maddening to holders that Dell may repatriate more than $3 billion of cash from overseas to fund the LBO -- and pay taxes -- but wouldn't return that cash to shareholders.

Michael Dell plans to retain his $3.7 billion stake in the company, put in another $750 million of additional cash, and get a $1.4 billion equity contribution from Silver Lake Partners, a private-equity firm. The buyout also would be funded by $13.75 billion in new debt, plus a $2 billion loan from Microsoft (MSFT).

The Bottom Line

The $13.65-a-share buyout offer for Dell is so low that there's little downside if the deal falls apart. The shares could rise if the company announced a tender offer instead.

A simple LBO model suggests that Michael Dell and Silver Lake could earn a 25%-plus annual return on their investment over five years, turning $5.85 billion of equity into about $20 billion. This scenario assumes no reduction in Dell's operating income over the five years and repayment of Dell's new buyout debt. Michael Dell is worth an estimated $15 billion, and a Dell LBO could make him much richer. His willingness to contribute the vast part of the equity in the buyout loudly attests to his belief in its economics.

There's little reason for Dell to go private. If anything, a private Dell with sizable debt would have a harder time completing its transition from a PC-focused company. "There's no logic for this deal other than greed," Pzena contends. **"If Michael Dell wants a bigger ownership stake, let Dell make a tender offer for the stock. Why does he have to force out everyone else?"**

Michael Dell is betting that shareholders won't oppose him in sufficient numbers to block the deal. Yet he might be underestimating their anger. After all, who wants to be on the short end of what could be the steal of the decade?

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