



Mossberg's Investor Digest

Idea Profile

Dell (Nasdaq: DELL)

DESCRIPTION:

Founded in 1984, Dell is the number one supplier of PCs in the U.S. and number two globally (15% global market share, 2007, IDC). In addition to PC's (60% of revenue), Dell offers Software and Peripherals (16%), Servers and Networking (11%), Services (9%) and Storage (4%). Dell benefits disproportionately from the U.S. corporate market, with over 50% of its revenues and more than 60% of profits coming from this segment.

KEY INVESTMENT CONSIDERATION:

Decline in margin is due to operating missteps, which are fixable – Since Michael Dell stepped down from the CEO spot in 2004, operating margin has declined from 8.6% in 2005 to 5.3% in 2007. Over the past year, Michael Dell has returned to the CEO spot, replaced the executive management team, and is putting in place new strategies that will drive operating margin improvements. The new executive team, which now totals 12 (down from 22 under the former CEO), is less bureaucratic and includes top-level talent including Mike Cannon, former CEO of Solectron, Steve Schuckenbrock, former COO of Electronic Data Systems Corporation, and Ron Garriques, former president of Motorola's Mobile Devices segment.

Cash generation machine – While the company is making changes to its business model, including ramping its retail channel sales, Dell's direct-to-customer business model is still the primary way it sells products to its customers. This means a large portion of its business still generates "negative working capital". This happens because customers pay for goods and services faster than Dell has to pay its vendors. For example, receivables and inventory were \$9.2 billion at the end of the last quarter, \$2 billion less than accounts payable. The end result is that the company needs less cash to finance its growth, and can use cash to repurchase shares, and/or make acquisitions.

Share repurchase – In the past 14 quarters, Dell has repurchased over 500 million shares for \$15 billion at approximately \$30 per share. This represents approximately 20% of shares outstanding. During the current fiscal year, the company has repurchased 112 million shares or \$2.5 billion. The company has \$5 billion remaining on its current share repurchase authorization, and expects to continue to buy back shares in the back half of its fiscal year. Apparently Michael Dell shares the view that the shares are undervalued. Since late June, he has bought an additional \$200 million of stock for a little above \$20 per share.

Dealing with a downturn in IT spending - The good news about the products that Dell sells are purchases can be deferred, but they don't get eliminated. Customers can delay the purchase of IT for a period of time; however, at some point, it becomes counterproductive to have tools that are too old. If customers don't upgrade their productivity tools they start to fall behind. Dell also has many options at its disposal to deal with an environment where customers or potential customers scale back or delay their technology investments. Dell has committed to taking \$3 billion/ year out of its cost structure and \$9 billion in cash gives it lots of options.

VALUATION:

Despite having 3x the revenue base and 2x the earnings, Dell's shares are currently trading at the same levels they were in 1998. The company is generating over \$1 billion in cash flow per quarter. After its minimal capital expenditure requirements, Dell generates over \$3.2 billion in cash flow each year. With an enterprise value of \$18 billion, the 5.6x free cash flow multiple is a very attractive price for a global leader.

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Investment Data (as of 11/8/08)

Recent Price	\$12.56
52-Week Range	10.59 - 28.40
Fiscal Year End	Jan
Dividend	N/A
Yield	N/A
Shares Outstanding	2.0 B
Average Trading Volume (3 mos)	34 MM
Market Capitalization	25 B
Cash	9.0 B
Long Term Debt	2.0 B
Enterprise Value (EV)	18 B
LT Debt/ Equity	0.7
BV/ Share	\$1.44
TTM Revenue	64 B
P/ Revenue	0.4x
TTM EPS	1.34
P/ EPS	9.4x
TTM EBITDA	4.3 B
EV/ TTM EBITDA	4x

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