

Some \$DVMT updates and additional thoughts

Now that I've had ~72 hours to reflect on getting screwed by Dell / talk to some other Dell victims (disclosure: long DVMT), I wanted to provide a quick update to my Tuesday write up.

In general, I think everything I said was within the realm of reasonableness. The biggest pushback I got was on my part about bumping in cash instead of stock. Several readers (correctly) pointed out that I shouldn't use the stub equity value to value Dell's equity; instead, I should use the implied equity value (i.e. the stub equity value plus the value of all of their equity stakes) because that's the market cap Dell will actually have. A silly mistake on my part (though, to be fair to myself, mistakes tend to get made when you're rushing through a situation / deal in less than 24 hours!).

Below I've recreated the table I used for valuing Dell. I was using the "implied Dell Stub" value of \$10.1B for Dell's equity value, but I should have been using the "implied equity" line of ~\$46.4B.

Value Recreation		
DVMT Per Share	\$ 94.00	\$ 94.00
DVMT Shares	199.4	199.40
Total Consideration	\$ 18.74	\$ 18.74
DVMT Cash	\$ (9.0)	\$ -
Stock Consideration	\$ 9.7	\$ 18.7
PF ownership	21%	31%
Implied Equity	\$ 46.4	\$ 60.5
Equity stakes value	\$ (36.3)	\$ (36.3)
Implied Dell Stub, before excess Cash	\$ 10.1	\$ 24.1
Excess VMW Cash	\$ -	\$ (9.0)
Implied Dell stub	\$ 10.1	\$ 15.1
LTM Non-Gapp NI	\$ 2.7	\$ 2.7
LTM FCF	\$ 3.0	\$ 3.0
LTM FCF before DFS	\$ 4.7	\$ 4.7
P/NI	3.7x	5.6x
Equity / FCF	3.4x	5.0x
Equity / FCF pre-DFS	2.1x	3.2x

That change makes a big difference: even though the Dell stub still has a negative implied equity value (looking through the value they're stealing

from DVMT), having that large of an equity value gives them a currency to bump their DVMT bid. If they're simply willing to bump DVMT's ownership from 21% to 26%, then the value of DVMT's equity goes up by ~\$2.3B ($\$46.4B \times (26\% - 21\%)$), or ~\$11.60/share. That bump would likely be enough to get a deal done, and Dell would still be capturing \$8-10B of value for themselves by taking out DVMT at a huge discount to their VMW shares.

So it probably makes sense that if/ when Dell comes with a bump, he / they will use equity, not cash. Sure, he's issuing undervalued Dell shares, but the company is extremely levered already (making cash a precious commodity) and who cares if you issue shares a little bit on the cheap (say for \$2B less than they're worth) if it lets you lock in an \$8B gain on the DVMT / VMW side.

Using the proper equity value also gives Dell a bit more leverage in the negotiations: I had said in my original article Dell couldn't credibly threaten DVMT with a "take this deal or we will IPO and then force convert you" scenario; with a semi-substantial bit of equity here (though a still negative core value) Dell does have some leverage to threaten an IPO. Ultimately, I still think the market is valuing core Dell cheaply enough that an IPO would be a tough slog. Plus, if Dell is going public for the somewhat explicit purpose of screwing over the DVMT minority shareholders, who is going to be lining up to buy a Dell IPO and become a Dell minority shareholder? "Sure, you screwed your minority shareholders over last time you were public and you semi-stole it from them in an IPO, but please take my money and give me non-voting shares in your highly levered controlled company so that you can rob a different set of minority shareholders." Seems unlikely to me.

Some other odds and ends

- Dell's ability to bump with equity also presents an interesting call option around the market's valuation of the stub. Dell is going to file an S4 in September and host an analyst day later in the month. If they can start to get the market semi-excited about Dell equity (it doesn't even take a massive multiple; just get some type of positive stub value), DVMT stock will start to creep up and Dell can give DVMT shareholders a big equity bump with only a small increase in dilution for Dell.
- If and when the DVMT deal wraps up, there's going to be some very interesting dynamics around Dell's float. Dell is going to be a very large company with a very tightly controlled stock given the high levels of insider

ownership. I would guess it's getting added to the indices at some point in the near future, which should create a natural base of buyers over time.

- I do think the Dell equity would be interesting at the levels the market is valuing it at. While the market will undoubtedly assign a conglomerate discount to all of Dell's equity stakes, I highly doubt Dell ever pays taxes on them; I would guess they eventually spin the stakes out tax free to shareholders. I would much rather be aligned with Dell at the Dell level and buy into those stakes at a discount than buy the controlled equities directly in the public market and risk some shenanigans from Dell at that level. Combine that "unwarranted" discount of the equity stake with a highly levered and cash generative core Dell, and I could see the stock appreciating significantly once it starts to trade and people start to see the underlying economics of the business.
- The WSJ is reporting [Carl Icahn is "unlikely" to push for a better deal](#) at DVMT after making \$200m on DVMT / VMW (disclosure: short a small amount). I find it tough to believe a guy who has made his fortune in large part on negotiating and activism is going to turn a situation he's involved in down just because he's already made a quick buck, but who knows? Maybe he just doesn't want to do the heavy lifting and is hoping someone else will step in here. All I know is this is a situation ripe for activism, and whether it's Icahn or someone else, I'd be surprised if someone didn't at least try to unlock some additional value here.