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## Research Update:

# Dell Inc. Is Upgraded To 'BB+' From 'BB-' On Revenue Growth And Reduced Debt; Outlook Stable; Debt Ratings Also Raised

### Primary Credit Analyst:

Martha P Toll-Reed, New York (1) 212-438-7867; molly.toll-reed@standardandpoors.com

### Secondary Contact:

David T Tsui, CFA, CPA, New York (1) 212-438-2138; david.tsui@standardandpoors.com

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## Research Update:

# Dell Inc. Is Upgraded To 'BB+' From 'BB-' On Revenue Growth And Reduced Debt; Outlook Stable; Debt Ratings Also Raised

## Overview

- U.S. information technology solutions provider Dell Inc. recently announced results for the quarter ended Oct. 31, 2014, including moderate revenue growth and significant debt reductions over the past 12 months.
- We are raising our corporate credit rating on Dell to 'BB+' from 'BB-'.
- The stable outlook reflects our expectation that Dell will maintain revenue growth and consistent profitability over the near term, and maintain adjusted leverage below 3x.

## Rating Action

On Dec. 4, 2014, Standard & Poor's Ratings Services raised its corporate credit rating on Round Rock, Tex.-based Dell Inc. to 'BB+' from 'BB-'. The outlook is stable.

At the same time, we raised the ratings on Dell's senior secured debt to 'BBB' from 'BB+', and on its senior unsecured debt to 'BB+' from 'B+'. We revised our recovery rating on Dell's senior unsecured debt to '3' from '5'. The '3' recovery rating reflects our expectation of meaningful (50%-70%) recovery in the event of a payment default.

## Rationale

The upgrade reflects our revision of Dell's financial risk profile to "intermediate" from "aggressive", incorporating our expectation that Dell will continue to reduce debt through its fiscal year ended Jan. 31, 2016, and will maintain adjusted leverage below 3x. Our ratings also reflect Dell's "fair" business risk profile, which incorporates:

- The company's strong brand name and good market position across its hardware product portfolio.
- A geographically diverse and broad customer base.
- Highly competitive market conditions and weak global demand for personal computers (included in Dell's client solutions segment, which comprise more than half of revenues).
- Our expectation that ongoing cost reduction actions will enable Dell to maintain consistent profitability.
- A modest mix of services and software revenues with higher growth and margin contribution potential.

Dell reported revenues for the quarter ended Oct. 31, 2014 in excess of \$14 billion. The current rating reflects our expectation that revenue predictability will be limited by highly competitive market conditions and declining demand for PCs. In addition, we believe evolving technologies and market conditions will require ongoing investment in Dell's growth businesses, including potential acquisitions. Based on total revenues, Dell is the third-largest U.S. computer systems company.

Adjusted EBITDA margins have benefitted from ongoing cost reduction actions and growth-related economies of scale. We believe that Dell will reinvest a portion of incremental cost savings in the businesses, which will limit adjusted EBITDA improvement in fiscal 2016. We view Dell's EBITDA margins to be "below average" for the technology hardware sector, and the company's volatility of profitability to be "fair."

Dell's "intermediate" financial risk profile reflects adjusted leverage (including our captive finance and surplus cash adjustment) below 2.5x as of Oct. 31, 2014. The rating incorporates Dell's commitment to use the majority of free operating cash flow to reduce debt over the near term. Moderate research and development spending and capital expenditures should enable the company to generate significantly positive annual free operating cash flow.

Our base-case scenario includes the following assumptions:

- U.S. GDP growth of 2.2% in 2014 and 3.0% in 2015.
- Global GDP growth of 3.7% in 2014 and 4.0% in 2015.
- Global IT spending growth in the low- to mid-single digits in the near term.
- Ongoing cost reduction and restructuring actions will sustain Dell's competitive cost position.
- We expect revenue mix dynamics and seasonality to result in some variability of EBITDA margins quarter to quarter.
- Potential acquisitions will be moderate in size and will not materially weaken Dell's financial profile.

Based on these assumptions, we arrive at the following credit measures:

- Moderate revenue growth in the near term.
- Consistent EBITDA margins.
- Adjusted debt to EBITDA remaining below the mid-2x area in fiscal 2016.

### **Liquidity**

In our view, Dell has "strong" liquidity. We expect net sources would be positive in the near term even with a 30% decline in EBITDA for the 12 months ended Oct. 31, 2014, and that coverage of uses will be in excess of 1.5x for the next 12 months.

Principal Liquidity Sources:

- Cash and cash equivalents along with free operating cash flow.
- Availability under Dell's \$2 billion asset-backed revolving credit facility maturing in 2018 (unrated).

Principal Liquidity Uses:

- Near-term debt maturities.
- Settlement of outstanding appraisal proceedings for Dell shareholders that did not vote in favor of the October 2013 LBO transaction.

## Outlook

The stable outlook reflects our expectation that Dell will achieve moderate revenue growth and consistent operating performance through the fiscal year ended Jan. 31, 2016. We expect the benefits from ongoing cost reduction initiatives will largely offset pricing pressure across Dell's primary business segments. In addition, we expect Dell will primarily focus on reducing leverage through EBITDA growth and some debt reduction.

### Upside scenario

Rating upside is currently limited by Dell's revenue and earnings vulnerability to declining global PC demand and modest earnings contribution from higher-margin software and services revenues. In addition, we would consider an upgrade upon management's establishment of financial policies more consistent with an investment-grade corporate credit rating.

### Downside scenario

Although unlikely in the near term, we could lower the rating if weak demand in Dell's end user and enterprise solutions segments, reduced profitability, or more aggressive financial policies result in adjusted leverage sustained at or above 3x.

## Ratings Score Snapshot

Corporate Credit Rating: BB+/Stable/--

Business risk: Fair

- Country risk: Low
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bb+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)

- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

## **Related Criteria And Research**

### **Related Criteria**

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Technology Hardware And Semiconductors Industry , Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt, Aug. 10, 2009

## **Ratings List**

Upgraded; Recovery Ratings Revised

	To	From
Dell Inc.		
Corporate Credit Rating	BB+/Stable/NR	BB-/Positive/NR
Senior Unsecured	BB+	B+
Recovery Rating	3	5

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