

DELL INC
Form 10-Q
June 03, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

(Mark One)

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**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended April 29, 2005

or

☐

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from to .

Commission File Number: 0-17017

Dell Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction
of incorporation or organization)

74-2487834

(I.R.S. Employer Identification No.)

One Dell Way

Round Rock, Texas 78682

(Address of Principal Executive Offices) (Zip Code)

(512) 338-4400

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No

As of the close of business on May 31, 2005, 2,421,082,061 shares of common stock, par value \$.01 per share, were outstanding.

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DELL INC.
CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(in millions; unaudited)

	April 29, 2005	January 28, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,874	\$ 4,747
Short-term investments	3,967	5,060
Accounts receivable, net	4,289	4,414
Inventories	483	459
Other	2,439	2,217
Total current assets	17,052	16,897
Property, plant and equipment, net	1,741	1,691
Investments	3,574	4,319
Other non-current assets	320	308
Total assets	\$ 22,687	\$ 23,215
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 9,057	\$ 8,895
Accrued and other	5,332	5,241
Total current liabilities	14,389	14,136
Long-term debt	504	505
Other non-current liabilities	2,170	2,089
Total liabilities	17,063	16,730
Stockholders' equity:		
Preferred stock and capital in excess of \$.01 par value; shares issued and outstanding: none		
Common stock and capital in excess of \$.01 par value; shares authorized: 7,000; shares issued: 2,776 and 2,769, respectively	8,400	8,195
Treasury stock, at cost: 334 and 284 shares, respectively	(12,758)	(10,758)
Retained earnings	10,108	9,174
Other comprehensive loss	(84)	(82)
Other	(42)	(44)
Total stockholders' equity	5,624	6,485

Total liabilities and stockholders equity	\$	22,687	\$	23,215
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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DELL INC.
CONDENSED CONSOLIDATED STATEMENT OF INCOME
(in millions, except per share amounts; unaudited)

	Three Months Ended	
	April 29, 2005	April 30, 2004
Revenue	\$ 13,386	\$ 11,540
Cost of revenue	10,895	9,467
Gross margin	2,491	2,073
Operating expenses:		
Selling, general and administrative	1,207	991
Research, development and engineering	110	116
Total operating expenses	1,317	1,107
Operating income	1,174	966
Investment and other income, net	59	49
Income before income taxes	1,233	1,015
Income tax provision	299	284
Net income	\$ 934	\$ 731
Earnings per common share:		
Basic	\$ 0.38	\$ 0.29
Diluted	\$ 0.37	\$ 0.28
Weighted average shares outstanding:		
Basic	2,456	2,539
Diluted	2,515	2,593

The accompanying notes are an integral part of these condensed consolidated financial statements.

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DELL INC.
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(in millions; unaudited)

	Three Months Ended	
	April 29, 2005	April 30, 2004
Cash flows from operating activities:		
Net income	\$ 934	\$ 731
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	91	82
Tax benefits from employee stock plans	32	25
Effects of exchange rate changes on monetary assets and liabilities denominated in foreign currencies	(80)	(114)
Other	18	2
Changes in:		
Operating working capital	103	81
Non-current assets and liabilities	92	195
Net cash provided by operating activities	1,190	1,002
Cash flows from investing activities:		
Investments:		
Purchases	(869)	(3,505)
Maturities and sales	2,726	3,264
Capital expenditures	(143)	(82)
Net cash provided by (used in) investing activities	1,714	(323)
Cash flows from financing activities:		
Repurchase of common stock	(2,000)	(1,131)
Issuance of common stock under employee plans and other	161	114
Net cash used in financing activities	(1,839)	(1,017)
Effect of exchange rate changes on cash and cash equivalents	62	96
Net increase (decrease) in cash and cash equivalents	1,127	(242)
Cash and cash equivalents at beginning of period	4,747	4,317
Cash and cash equivalents at end of period	\$ 5,874	\$ 4,075

The accompanying notes are an integral part of these condensed consolidated financial statements.

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DELL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Dell Inc. (Dell) should be read in conjunction with the consolidated financial statements and notes thereto filed with the U.S. Securities and Exchange Commission (SEC) in Dell 's Annual Report on Form 10-K for the fiscal year ended January 28, 2005. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments of a normal recurring nature considered necessary to present fairly the financial position of Dell and its consolidated subsidiaries as of April 29, 2005 and January 28, 2005; and the results of its operations and its cash flows for the three month periods ended April 29, 2005 and April 30, 2004.

NOTE 2 INVENTORIES

	April 29, 2005	January 28, 2005
	(in millions)	
Inventories:		
Production materials	\$ 266	\$ 228
Work-in-process	77	58
Finished goods	140	173
	\$ 483	\$ 459

NOTE 3 EARNINGS PER COMMON SHARE AND PRO FORMA EFFECTS OF STOCK-BASED COMPENSATION

Earnings Per Common Share Basic earnings per share is based on the weighted effect of all common shares issued and outstanding, and is calculated by dividing net income by the weighted average shares outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted average number of common shares used in the basic earnings per share calculation plus the number of common shares that would be issued assuming exercise or conversion of all potentially dilutive common shares outstanding.

Dell excludes equity instruments from the calculation of diluted weighted average shares outstanding if the effect of including such instruments is antidilutive to earnings per share. Accordingly, certain employee stock options have been excluded from the calculation of diluted weighted average shares totaling 72 million and 133 million shares for the first quarter of fiscal 2006 and 2005, respectively.

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DELL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

The following table sets forth the computation of basic and diluted earnings per share for the three month periods ended April 29, 2005 and April 30, 2004:

	Three Months Ended	
	April 29, 2005	April 30, 2004
	(in millions, except per share amounts)	
Numerator:		
Net income	\$ 934	\$ 731
Denominator:		
Weighted average shares outstanding:		
Basic	2,456	2,539
Employee stock options and other	59	54
Diluted	2,515	2,593
Earnings per common share:		
Basic	\$ 0.38	\$ 0.29
Diluted	\$ 0.37	\$ 0.28

Pro Forma Effects of Stock-Based Compensation Dell currently applies the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations when accounting for its stock-based compensation plans. Dell applies the disclosure provisions of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-based Compensation-Transition and Disclosure*, as if the fair-value method had been applied in measuring compensation expense. Under APB Opinion No. 25, when the exercise price of a fixed employee stock option equals the market price of the underlying stock on the grant date, no compensation expense is recognized. Under SFAS No. 123, the value of each option is estimated on the date of grant using the Black-Scholes option pricing model, which was developed for use in estimating the value of freely traded options.

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DELL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

The following table sets forth the computation of basic and diluted earnings per share for the three month periods ended April 29, 2005 and April 30, 2004, and illustrates the effect on net income and earnings per share as if Dell had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation. As the relatively larger stock option awards granted in prior years fully vest we expect that, over time, our stock-based compensation expense will decline.

Three Months Ended		
	April 29, 2005	April 30, 2004
	(in millions, except per share amounts)	
Net income as reported	\$ 934	\$ 731
Deduct: Total stock-based employee compensation determined under fair value method for all awards, net of related tax effects	(213)	(202)
Net income pro forma	\$ 721	\$ 529
Earnings per common share:		
Basic as reported	\$ 0.38	\$ 0.29
Basic pro forma	\$ 0.29	\$ 0.21
Diluted as reported	\$ 0.37	\$ 0.28
Diluted pro forma	\$ 0.29	\$ 0.21

NOTE 4 COMPREHENSIVE INCOME

Dell's comprehensive income is comprised of net income, foreign currency translation adjustments, unrealized gains and losses on derivative financial instruments related to foreign currency hedging, and unrealized gains and losses on marketable securities classified as available-for-sale. Comprehensive income for the three month periods ended April 29, 2005 and April 30, 2004, was as follows:

Three Months Ended		
	April 29, 2005	April 30, 2004
	(in millions)	
Comprehensive income:		
Net income	\$ 934	\$ 731
Unrealized gains on foreign currency hedging instruments, net of taxes	8	114
Unrealized losses on marketable securities, net of taxes	(11)	(33)
Foreign currency translations	1	(3)
Total comprehensive income, net of taxes	\$ 932	\$ 809

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DELL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

NOTE 5 AGGREGATE DEFERRED REVENUE AND WARRANTY LIABILITY

Dell records warranty liabilities at the time of sale for the estimated costs that may be incurred under its basic limited warranty. Revenue from extended warranty and service contracts, for which Dell is obligated to perform, is recorded as deferred revenue and subsequently recognized over the term of the contract or when the service is completed. Changes in Dell's aggregate deferred revenue and warranty liability are presented in the following table:

	Three Months Ended	
	April 29, 2005	April 30, 2004
	(in millions)	
Aggregate deferred revenue and warranty liability at beginning of period	\$ 3,594	\$ 2,694
Revenue deferred and costs accrued for new warranties	933	683
Service obligations honored	(339)	(275)
Amortization of deferred revenue	(427)	(288)
Aggregate deferred revenue and warranty liability at end of period	\$ 3,761	\$ 2,814

NOTE 6 DELL FINANCIAL SERVICES

Dell is currently a partner in Dell Financial Services L.P. (DFS), a joint venture with CIT Group Inc. (CIT). In general, DFS facilitates customer financing transactions through either loan or lease financing. Dell recognized revenue from the sale of products pursuant to loan and lease financing transactions of \$1.5 billion and \$1.3 billion during the three month periods ended April 29, 2005 and April 30, 2004, respectively.

Dell currently owns a 70% equity interest in DFS. Dell began consolidating DFS's financial results due to the adoption of Financial Accounting Standards Board (FASB) Interpretations No. 46R (FIN 46R). Based on the guidance in FIN 46R, Dell concluded that DFS is a variable interest entity and Dell is the primary beneficiary of DFS's expected cash flows. CIT's equity ownership in the net assets of DFS was \$13 million as of April 29, 2005 and January 28, 2005, which is recorded as minority interest and included in other non-current liabilities on Dell's condensed consolidated statement of financial position.

Dell has the option to purchase CIT's 30% interest in DFS in February 2008 for a purchase price ranging from \$100 million to \$345 million, depending on DFS's profitability. If Dell does not exercise this purchase option, Dell is obligated to purchase CIT's 30% interest upon the occurrence of certain termination events, or expiration of the joint venture on January 29, 2010 for a purchase price ranging from \$100 million to \$345 million.

DFS maintains credit facilities with CIT, which provide DFS with a funding capacity of up to \$1.0 billion. As of April 29, 2005 and January 28, 2005, outstanding advances under these facilities totaled \$152 million and \$158 million, respectively, and are included in other current and non-current liabilities on Dell's condensed consolidated statement of financial position. Dell is dependent upon DFS to provide financing for a significant number of customers who elect to finance Dell products, and DFS is dependent upon CIT to access the capital markets to provide funding for these transactions. If CIT were unable to access the capital markets, Dell would be required to find additional alternative sources of financing for its customers or self-finance these activities.

During the fourth quarter of fiscal 2005, Dell began selling certain loan and lease finance receivables to an unconsolidated qualifying special purpose entity that is wholly owned by Dell. The qualifying special purpose entity is a separate legal entity with assets and liabilities separate from those of Dell. The qualifying special purpose entity has

entered into a financing arrangement with a multiseller conduit that in turn issues asset-backed debt securities to the capital markets. Transfers of financing receivables are recorded in accordance with the provisions of SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*. The sale of these loan and lease financing receivables did not have a material impact on Dell's consolidated financial position, results of operations, or cash flows for the first quarter of fiscal 2006.

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DELL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

NOTE 7 SEGMENT INFORMATION

Dell conducts operations worldwide and is managed in three geographic segments: the Americas, Europe, and Asia Pacific-Japan regions. The Americas region, which is based in Round Rock, Texas, covers the U.S., Canada, and Latin America. Within the Americas, Dell is further segmented into Business and U.S. Consumer. The Americas Business segment includes sales to corporate, government, healthcare, education, and small and medium business customers, while the U.S. Consumer segment includes sales primarily to individual consumers. The European region, which is based in Bracknell, England, covers Europe, the Middle East, and Africa. The Asia Pacific-Japan region covers the Pacific Rim, including Australia and New Zealand, and is based in Singapore.

The accounting policies of Dell's reportable segments are the same as those described in the summary of significant accounting policies in its Annual Report on Form 10-K for the fiscal year ended January 28, 2005. Dell allocates resources to and evaluates the performance of its segments based on operating income. Corporate expenses are included in Dell's measure of segment operating income for management reporting purposes. The table below presents information about Dell's reportable segments for the three month periods ended April 29, 2005 and April 30, 2004:

	Three Months Ended	
	April 29, 2005	April 30, 2004
	(in millions)	
Net revenue:		
Americas:		
Business	\$ 6,616	\$ 5,758
U.S. Consumer	1,945	1,738
Total Americas	8,561	7,496
Europe	3,171	2,653
Asia Pacific-Japan	1,654	1,391
Total net revenue	\$ 13,386	\$ 11,540
Operating income:		
Americas:		
Business	\$ 660	\$ 565
U.S. Consumer	145	96
Total Americas	805	661
Europe	236	198
Asia Pacific-Japan	133	107
Total operating income	\$ 1,174	\$ 966

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**DELL INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)**

NOTE 8 SUBSEQUENT EVENT

On October 22, 2004, the American Jobs Creation Act of 2004 (the Act) was signed into law. Among other items, the Act creates a temporary incentive for U.S. multinationals to repatriate accumulated income earned outside the U.S. at a tax rate of 5.25%, versus the U.S. federal statutory rate of 35%. In the fourth quarter of fiscal 2005 Dell determined that it would repatriate \$4.1 billion in foreign earnings. Accordingly, Dell recognized a tax repatriation charge of \$280 million in accordance with SFAS No. 109, *Accounting for Income Taxes*. This tax charge included an amount relating to a drafting oversight that Congressional leaders expected to correct in calendar year 2005. On May 10, 2005, the Department of Treasury issued further guidance that addressed the drafting oversight. Dell is evaluating the impact of this regulatory guidance to determine the amount of the repatriation charge reduction to be recognized in the second quarter of fiscal 2006. The repatriation is required to be completed by the e