

DELL INC
Form 10-Q
June 03, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-Q

(Mark One)

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

For the quarterly period ended May 2, 2008

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 a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of the close of business on May 30, 2008, 2,020,946,756 shares of common stock, par value \$.01 per share, were outstanding.

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DELL INC.
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(in millions)

	May 2, 2008 (unaudited)	February 1, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 8,273	\$ 7,764
Short-term investments	228	208
Accounts receivable, net	6,002	5,961
Financing receivables, net	1,548	1,732
Inventories	1,258	1,180
Other	3,193	3,035
Total current assets	20,502	19,880
Property, plant, and equipment, net	2,642	2,668
Investments	1,312	1,560
Long-term financing receivables, net	375	407
Goodwill	1,691	1,648
Purchased intangible assets, net	808	780
Other non-current assets	689	618
Total assets	\$ 28,019	\$ 27,561
LIABILITIES AND EQUITY		
Current liabilities:		
Short-term borrowings	\$ 131	\$ 225
Accounts payable	10,891	11,492
Accrued and other	3,829	4,323
Short-term deferred service revenue	2,518	2,486
Total current liabilities	17,369	18,526
Long-term debt	1,848	362
Long-term deferred service revenue	2,906	2,774
Other non-current liabilities	2,350	2,070
Total liabilities	24,473	23,732
Commitments and contingencies (Note 9)	92	94

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Redeemable common stock and capital in excess of \$.01 par value; shares issued and outstanding: 4 and 4, respectively (Note 12)

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: 3,329 and 3,320, respectively; shares outstanding: 2,017 and 2,060, respectively

Treasury stock at cost: 837 and 785 shares, respectively

Retained earnings

Accumulated other comprehensive loss

Total stockholders' equity

Total liabilities and equity

-	-
10,652	10,589
(26,068)	(25,037)
18,983	18,199
(113)	(16)
3,454	3,735
\$ 28,019	\$ 27,561

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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

	Three Months Ended	
	May 2, 2008	May 4, 2007
Net revenue	\$ 16,077	\$ 14,722
Cost of net revenue	13,112	11,884
Gross margin	2,965	2,838
Operating expenses:		
Selling, general, and administrative	1,912	1,763
Research, development, and engineering	152	142
In-process research and development	2	-
Total operating expenses	2,066	1,905
Operating income	899	933
Investment and other income, net	125	78
Income before income taxes	1,024	1,011
Income tax provision	240	255
Net income	\$ 784	\$ 756
Earnings per common share:		
Basic	\$ 0.39	\$ 0.34
Diluted	\$ 0.38	\$ 0.34
Weighted-average shares outstanding:		
Basic	2,036	2,234
Diluted	2,040	2,254

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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DELL INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions, unaudited)

	Three Months Ended	
	May 2, 2008	May 4, 2007
Cash flows from operating activities:		
Net income	\$ 784	\$ 756
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	185	132
Stock-based compensation	50	97
Excess tax benefits from stock-based compensation	-	(12)
Effects of exchange rate changes on monetary assets and liabilities denominated in foreign currencies	(90)	22
Other	39	31
Changes in:		
Operating working capital	(882)	(1,054)
Non-current assets and liabilities	57	(71)
Net cash provided by (used in) operating activities	143	(99)
Cash flows from investing activities:		
Investments:		
Purchases	(172)	(1,104)
Maturities and sales	434	1,068
Acquisition of business, net of cash and cash equivalents acquired	(170)	-
Capital expenditures	(122)	(171)
Net cash used in investing activities	(30)	(207)
Cash flows from financing activities:		
Repurchase of common stock	(1,031)	-
Issuance of common stock under employee plans	21	21
Excess tax benefits from stock-based compensation	-	12
Issuance (payment) of commercial paper, net	101	(40)
Repayments of borrowings	(200)	(17)
Proceeds from borrowings	1,490	12
Other	6	(1)
Net cash provided by (used in) financing activities	387	(13)
Effect of exchange rate changes on cash and cash equivalents	9	33
Net increase (decrease) in cash and cash equivalents	509	(286)

Cash and cash equivalents at beginning of period	7,764	9,546
Cash and cash equivalents at end of period	\$ 8,273	\$ 9,260

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

Basis of Presentation The accompanying condensed consolidated financial statements of Dell Inc. (Dell) should be read in conjunction with the consolidated financial statements and accompanying notes filed with the U.S. Securities and Exchange Commission (SEC) in Dell s Annual Report on Form 10-K for the fiscal year ended February 1, 2008. The accompanying 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 condensed consolidated financial statements reflect all adjustments of a normal recurring nature considered necessary to fairly state the financial position of Dell and its consolidated subsidiaries at May 2, 2008, and the results of its operations and its cash flows for the three month periods ended May 2, 2008, and May 4, 2007.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in Dell s condensed consolidated financial statements and the accompanying notes. Actual results could differ materially from those estimates.

Dell Financial Services L.P. (DFS), formerly a joint venture with CIT Group Inc. (CIT), has been a wholly-owned subsidiary since January 1, 2008. DFS s financial results have previously been consolidated by Dell in accordance with Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 46R (FIN 46R), as Dell was the primary beneficiary. DFS allows Dell to provide its customers with various financing alternatives. See Note 5 of Notes to Condensed Consolidated Financial Statements for additional information.

Out of Period Adjustments In the first quarter of Fiscal 2009 Dell recorded adjustments related to net revenue, cost of net revenue, operating expenses, and investment and other income that in the aggregate increased income before tax by approximately \$110 million. The two largest of these corrections include a reversal of the provision for Fiscal 2008 employee bonuses and a foreign exchange rate error. Correcting these errors increased income before tax by \$46 million and \$42 million, respectively. Because these errors, both individually and in the aggregate, were not material to any of the prior years financial statements, and the impact of correcting these errors in the current year is not expected to be material to the full year Fiscal 2009 financial statements, Dell recorded the correction of these errors in the first quarter of Fiscal 2009 financial statements.

Recently Issued and Adopted Accounting Pronouncements In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, provides a framework for measuring fair value, and expands the disclosures required for assets and liabilities measured at fair value. SFAS 157 applies to existing accounting pronouncements that require fair value measurements; it does not require any new fair value measurements. Dell adopted the effective portions of SFAS 157 beginning the first quarter of Fiscal 2009. See Note 6 of Notes to Condensed Consolidated Financial Statements for the impact of the adoption.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), which provides companies with an option to report selected financial assets and liabilities at fair value with the changes in fair value recognized in earnings at each subsequent reporting date. SFAS 159 provides an opportunity to mitigate potential volatility in earnings caused by measuring related assets and liabilities differently, and it may reduce the need for applying complex hedge accounting provisions. While SFAS 159 became effective for Dell s 2009 fiscal year, Dell did not elect the fair value measurement option for any of its financial assets or liabilities.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* (SFAS 161), which requires additional disclosures about the objectives of derivative instruments and hedging activities, the method of accounting for such instruments under SFAS No. 133 and its related interpretations, and a tabular disclosure of the effects of such instruments and related hedged items on a company s financial position, financial performance, and cash flows. SFAS No. 161 does not change the

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(unaudited)

accounting treatment for derivative instruments and is effective for us beginning Fiscal 2010. Management is currently evaluating the impact of the disclosure requirements of SFAS 161.

NOTE 2 INVENTORIES

	May 2, 2008	February 1, 2008^(a)
	(in millions)	
<i>Inventories:</i>		
Production materials	\$ 743	\$ 714
Work-in-process	173	144
Finished goods	342	322
 Inventories	 \$ 1,258	 \$ 1,180

(a) Certain prior period amounts have been changed to conform to the current year presentation. As a result, \$46 million has been reclassified from production materials and work-in-process to finished goods. There is no impact to the condensed consolidated financial statements as a result of this change.

NOTE 3 EARNINGS PER COMMON SHARE

Basic earnings per share is based on the weighted-average 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 earnings per share if the effect of including such instruments is antidilutive. Accordingly, certain stock-based incentive awards have been excluded from the calculation of diluted earnings per share totaling 275 million and 285 million shares for the first quarter of Fiscal 2009 and Fiscal 2008, respectively.

The following table sets forth the computation of basic and diluted earnings per share for the three month periods ended May 2, 2008, and May 4, 2007:

Three Months Ended	
May 2, 2008	May 4, 2007

**(in millions, except
per share amounts)**

Numerator:		
Net income	\$ 784	\$ 756
Denominator:		
Weighted-average shares outstanding:		
Basic	2,036	2,234
Effect of dilutive options, restricted stock units, restricted stock, and other	4	20
Diluted	2,040	2,254
Earnings per common share:		
Basic	\$ 0.39	\$ 0.34
Diluted	\$ 0.38	\$ 0.34

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(unaudited)**NOTE 4 COMPREHENSIVE INCOME**

The following table summarizes comprehensive income for the three month periods ended May 2, 2008, and May 4, 2007:

	Three Months Ended	
	May 2,	May 4,
	2008	2007
	(in millions)	
<i>Comprehensive income:</i>		
Net income	\$ 784	\$ 756
Unrealized losses on foreign currency hedging instruments, net	(31)	(82)
Unrealized (losses) gains on marketable securities, net	(25)	12
Foreign currency translation adjustments	(41)	1
Comprehensive income	\$ 687	\$ 687

NOTE 5 FINANCIAL SERVICES**Dell Financial Services L.P.**

Dell offers or arranges various financing options and services for its business and consumer customers in the U.S. through DFS, a wholly-owned subsidiary of Dell. DFS was formerly a joint venture between Dell and CIT, but on December 31, 2007, Dell purchased CIT's remaining 30% interest in DFS, making it a wholly-owned subsidiary. DFS is a full service financial services entity; key activities include the origination, collection, and servicing of customer receivables related to the purchase of Dell products.

Dell utilizes DFS to facilitate financing for a significant number of customers who elect to finance products sold by Dell. New financing originations, which represent the amounts of financing provided to customers for equipment and related software and services through DFS, were \$1.1 billion and \$1.4 billion during the three month periods ended May 2, 2008, and May 4, 2007, respectively.

CIT continues to have the right to purchase a minimum percentage of DFS's customer receivables until January 29, 2010 (Fiscal 2010). CIT's minimum funding right is 35% in Fiscal 2009 and 25% in Fiscal 2010 of the new customer receivables facilitated by DFS. CIT has the right to accelerate all or a portion of the Fiscal 2010 funding rights into Fiscal 2009. If CIT chooses not to accelerate the Fiscal 2010 funding rights, Dell has the option to purchase any of CIT's Fiscal 2010 funding rights that CIT did not accelerate into Fiscal 2009. In the three-month period ended May 2, 2008, CIT's funding percentage was approximately 35%.

DFS services the receivables purchased by CIT. However, Dell's obligation related to the performance of the DFS originated receivables purchased by CIT is limited to the cash funded credit reserves established at the time of funding.

Dell is undertaking a strategic assessment of ownership alternatives for certain DFS financing activities. The assessment is primarily focused on the consumer and small-and-medium business revolving credit financing receivables and operations in the U.S., but may also include commercial leasing. The outcome of the assessment will depend on the customer, capital, and economic impact of alternative ownership structures. It is possible the assessment will result in no change to the ownership and operating structure. We expect to complete our assessment in the third quarter of Fiscal 2009.

Table of Contents**DELL INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
(unaudited)**Financing Receivables**

The following table summarizes the components of Dell's financing receivables, net of the allowance for estimated uncollectible amounts:

	May 2, 2008	February 1, 2008
	(in millions)	
<i>Financing receivables, net:</i>		
Customer receivables:		
Revolving loans, gross	\$ 776	\$ 1,063
Fixed-term leases and loans, gross	635	654
Customer receivables, gross	1,411	1,717
Customer receivables allowance	(93)	(96)
Customer receivables, net	1,318	1,621
Residual interest	288	295
Retained interest	317	223
Financing receivables, net	\$ 1,923	\$ 2,139
Short-term	\$ 1,548	\$ 1,732
Long-term	375	407
Financing receivables, net	\$ 1,923	\$ 2,139

Financing receivables consist of customer receivables, residual interest, and retained interest in securitized receivables. Customer receivables include fixed-term loans and leases and revolving loans resulting from the sale of Dell products and services. Dell enters into sales-type lease arrangements with customers who desire lease financing. Of the customer receivables balance at May 2, 2008, and February 1, 2008, \$96 million and \$444 million, respectively, represent balances which are due from CIT in connection with specified promotional programs.

Customer receivables are presented net of allowance for uncollectible accounts. The allowance is based on factors including historical experience, past due receivables, receivable type, and the risk composition of the receivables. The composition and credit quality varies from investment grade commercial customers to subprime consumers. Subprime receivables comprise less than 20% of the net customer receivable balance at May 2, 2008. Customer receivables are charged to the allowance at the earlier of when an account is deemed to be uncollectible or when an account is 180 days delinquent. Recoveries on customer receivables previously charged off as uncollectible are recorded to the allowance for uncollectible accounts. The following is a description of the components of customer

receivables.

Revolving loans offered under private label credit financing programs provide qualified customers with a revolving credit line for the purchase of products and services offered by Dell. Revolving loans bear interest at a variable annual percentage rate that is tied to the prime rate. From time to time, account holders may have the opportunity to finance their Dell purchases with special programs during which, if the outstanding balance is paid in full, no interest is charged. These special programs generally range from 3 to 12 months and have an average original term of approximately 12 months. At May 2, 2008, and February 1, 2008, \$430 million and \$668 million, respectively, were receivables under these special programs.

Leases with business customers have fixed terms of two to five years. Future maturities of minimum lease payments at May 2, 2008, are as follows: 2009: \$123 million; 2010: \$94 million; 2011: \$45 million; 2012:

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(unaudited)

\$19 million; and 2013: \$3 million. Fixed-term loans are also offered to qualified small businesses and primarily consist of loans with short-term maturities.

The following table presents the net credit losses and customer receivables accounts 60 days or more past due.

	Three months ended			
	May 2, 2008		May 4, 2007	
	Dollars	%	Dollars	%
	(in millions, except percentages)			
Net credit losses of customer financing receivables	\$ 18	4.9% ^(a)	\$ 7	2.7% ^(a)
Customer financing receivables 60 days or more delinquent	\$ 38	2.6% ^(b)	\$ 12	0.8% ^(b)

- (a) Net credit losses for the quarter as a percentage of the outstanding average customer receivables balance over the quarter, multiplied by four.
- (b) Customer financing receivables 60 days or more delinquent divided by the ending customer financing receivables balance.

Dell retains a residual interest in the leased equipment. The amount of the residual interest is established at the inception of the lease based upon estimates of the value of the equipment at the end of the lease term using historical studies, industry data, and future value-at-risk demand valuation methods. On a periodic basis, Dell assesses the carrying amount of its recorded residual values for impairment. Anticipated declines in specific future residual values that are considered to be other-than-temporary are recorded in current earnings.

Retained interests represent the residual beneficial interest Dell retains in certain pools of securitized financing receivables. Retained interests are stated at the present value of the estimated net beneficial cash flows after payment of all senior interests. In estimating the value of retained interests, Dell makes a variety of financial assumptions, including pool credit losses, payment rates, and discount rates. These assumptions are supported by both Dell's historical experience and anticipated trends relative to the particular receivable pool. Dell reviews its investments in retained interests periodically for impairment, based on estimated fair value. All gains and losses are recognized in income immediately.

Dell values the retained interest at the time of each receivable sale and at the end of each reporting period. Dell determines the fair value of retained interest using a discounted cash flow model with various key assumptions, including payment rates, credit losses, discount rates, and remaining life of the receivables sold.

The monthly payment rate is the most significant estimate involved in the measurement process. Other significant estimates include the credit loss rate and the discount rate. These estimates are based on management expectations of future payment rates and credit loss rates, reflecting our historical rate of payments and credit losses, industry trends, current market interest rates, expected future interest rates, and other considerations.

The implementation of SFAS 157 did not result in material changes to the models or processes used to value retained interest. See Note 6 of Notes to Condensed Consolidated Financial Statements for the impact of the implementation of SFAS 157.

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(unaudited)

The following table summarizes the activity in retained interest balances for the three-month periods ended May 2, 2008, and May 4, 2007:

	Three months ended	
	May 2,	May 4,
	2008	2007
	(in millions)	
<i>Retained interest:</i>		
Retained interest at beginning of period	\$ 223	\$ 158
Issuances	156	43
Distributions from conduits	(55)	(40)
Net accretion	10	3
Change in fair value for the period	(17)	-
Retained interest at end of period	\$ 317	\$ 164

The table below summarizes the assumptions used to measure the fair value of the retained interest as of May 2, 2008:

	Weighted Average Key Assumptions			
	Monthly Payment Rates	Credit Losses (lifetime)	Discount Rates (annualized)	Life (months)
Time of sale valuation of retained interest	11%	8%	16%	13
Valuation of retained interests	8%	11%	14%	12

The impact of adverse changes to the key valuation assumptions to the fair value of retained interest at May 2, 2008, is shown in the following table:

	May 2, 2008
	(in millions)
<i>Adverse change of:</i>	
Expected prepayment speed: 10%	\$ (7)
Expected prepayment speed: 20%	\$ (12)
Expected credit losses: 10%	\$ (11)
Expected credit losses: 20%	\$ (22)
Discount rate: 10%	\$ (4)
Discount rate: 20%	\$ (9)

The analyses above utilized 10% and 20% adverse variation in assumptions to assess the sensitivities in fair value of the retained interest. However, these changes generally cannot be extrapolated because the relationship between a change in one assumption to the resulting change in fair value may not be linear. For the above sensitivity analyses, each key assumption was isolated and evaluated separately. Each assumption was adjusted by 10% and 20% while holding the other key assumptions constant. Assumptions may be interrelated, and changes to one assumption may impact others and the resulting fair value of the retained interest. For example, increases in market interest rates may result in lower prepayments and increased credit losses. The effect of multiple assumption changes were not considered in the analyses.

Asset Securitization

During the first three months of Fiscal 2009 and Fiscal 2008, Dell sold \$421 million and \$296 million, respectively, of fixed-term leases and loans and revolving loans to unconsolidated qualifying special purpose entities. The

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(unaudited)

qualifying special purpose entities are bankruptcy remote legal entities with assets and liabilities separate from those of Dell. The sole purpose of the qualifying special purpose entities is to facilitate the funding of financing receivables in the capital markets. Dell determines the amount of receivables to securitize based on its funding requirements in conjunction with specific selection criteria designed for the transaction. The qualifying special purpose entities have entered into financing arrangements with three multi-seller conduits that, in turn, issue asset-backed debt securities in 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 Extinguishments of Liabilities – a Replacement of FASB Statement No. 125* (SFAS 140). The principal balance of the securitized receivables at May 2, 2008, and February 1, 2008, was \$1.4 billion and \$1.2 billion, respectively.

Dell retains the right to receive collections on securitized receivables in excess of amounts needed to pay interest and principal as well as other required fees. Upon the sale of the financing receivables, Dell records the present value of the excess cash flows as a retained interest. Dell services the securitized contracts and earns a servicing fee. Dell's securitization transactions generally do not result in servicing assets and liabilities, as the contractual fees are adequate compensation in relation to the associated servicing cost.

Dell securitization programs contain standard structural features related to the performance of the securitized receivables. These structural features include defined credit losses, delinquencies, average credit scores, and excess collections above or below specified levels. In the event one or more of these features are met and Dell is unable to restructure the program, no further funding of receivables will be permitted, and the timing of expected retained interest cash flows will be delayed, which would impact the valuation of the retained interest. Should these events occur, Dell does not expect a material adverse affect on the valuation of the retained interest or on Dell's ability to securitize financing receivables.

The following table presents the net credit losses and accounts 60 days or more past due of the securitized receivables:

	Three months ended			
	May 2, 2008		May 4, 2007	
	Dollars	%	Dollars	%
	(in millions, except percentages)			
Net credit losses of securitized financing receivables	\$ 28	8.7% ^(a)	\$ 17	6.6% ^(a)
Securitized financing receivables 60 days or more delinquent	\$ 49	3.6% ^(b)	\$ 33	3.2% ^(b)

(a) Net credit losses for the quarter as a percentage of the average outstanding securitized financing receivables over the quarter, multiplied by four.

(b) Securitized financing receivables 60 days or more delinquent divided by the ending securitized financing receivables balance.

NOTE 6 FAIR VALUE

On February 2, 2008, Dell adopted the effective portions of SFAS 157. In February 2008 the FASB issued FSP FAS 157-2, Effective Date of FASB Statement No. 157, which provides a one year deferral of the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Therefore, we adopted the provisions of SFAS 157 with respect to only financial assets and liabilities. SFAS 157 defines fair value, establishes a framework for measuring fair value and enhances disclosure requirements for fair value measurements. This statement does not require any new fair value measurements. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, Dell uses various methods including market, income, and cost approaches. Dell utilizes valuation techniques that maximize the use of observable inputs and minimizes the use of unobservable inputs. The

Table of Contents**DELL INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
(unaudited)

adoption of this statement did not have a material effect on the consolidated financial statements for the first quarter of Fiscal 2009.

As a basis for categorizing these inputs, SFAS 157 establishes the following hierarchy which prioritizes the inputs used to measure fair value from market based assumptions to entity specific assumptions:

Level 1: Inputs based on quoted market prices for identical assets or liabilities in active markets at the measurement date.

Level 2: Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the instruments valuation.

The following table presents the Company's hierarchy for its assets and liabilities measured at fair value on a recurring basis as of May 2, 2008:

	Level 1 Quoted Prices in Active Markets for Identical Assets	Level 2 Significant Other Observable Inputs (in millions)	Level 3 Significant Unobservable Inputs	Total
Investments - available for sale securities	\$ -	\$ 1,402	\$ 25	\$ 1,427
Investments - trading securities	3	104	-	107
Retained interest	-	-	317	317
Derivative instruments	-	51	-	51
Total assets measured at fair value on recurring basis	\$ 3	\$ 1,557	\$ 342	\$ 1,902
Derivative instruments	-	119	-	119
Total liabilities measured at fair value on recurring basis	\$ -	\$ 119	\$ -	\$ 119

The following section describes the valuation methodologies Dell uses to measure financial instruments at fair value:

Investments Available for Sale The majority of Dell's investment portfolio consists of various fixed income securities such as U.S. government and agencies, U.S. and international corporate, and state and municipal bonds. This portfolio of investments, as of May 2, 2008, is valued based on model driven valuations whereby all significant inputs are observable or can be derived from or corroborated by observable market data for substantially the full term of the asset. The Level 3 position represents a convertible debt security that Dell was unable to corroborate with observable market data. The investment is valued at cost plus accrued interest as this is management's best estimate of fair value due to the recent acquisition of the investment.

Investments Trading Securities The majority of Dell's trading portfolio consists of various mutual funds and equity securities. The Level 1 securities are valued using quoted prices for identical assets in active markets. The Level 2 securities include various mutual funds that are not exchange traded and valued at their net asset value, which can be market corroborated.

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Retained Interests in Securitized Receivables The fair value of the retained interest is determined using a discounted cash flow model. Significant assumptions to the model include pool credit losses, payment rates, and discount rates. These assumptions are supported by both historical experience and anticipated trends relative to the particular receivable pool. Retained interest in securitized receivables is included in financing receivables, current and long-term, on the Condensed Consolidated Statement of Financial Position. See Note 5 of Notes to Condensed Consolidated Financial Statements for additional information about retained interest.

Derivative Instruments Dell's derivative financial instruments consist of interest rate swaps and foreign currency forward and purchased option contracts. The portfolio is valued using internal models based on market observable inputs, including interest rate curves and both forward and spot prices for currencies, implied volatilities, and credit risk.

The following table shows a reconciliation of the beginning and ending balances for fair value measurements using significant unobservable inputs:

	Retained Interest	Investments Available for Sale (in millions)	Total
Balance at February 1, 2008	\$ 223	\$ -	\$ 223
Net unrealized losses included in earnings	(7)	-	(7)
Purchase	-	25	25
Issuances and settlements	101	-	101
Balance at May 2, 2008	\$ 317	\$ 25	\$ 342

Unrealized gains or (losses) for the three months ended May 2, 2008, related to the Level 3 retained interest asset still held at the reporting date, are reported in income.

Items Measured at Fair Value on a Nonrecurring Basis Certain assets and liabilities are measured at fair value on a nonrecurring basis and therefore not included in the recurring fair value table. Dell did not record any change in fair value for these assets and liabilities during the first quarter of 2009.

NOTE 7 ACQUISITIONS

Dell completed two acquisitions, The Networked Storage Company and MessageOne, Inc., in the first quarter of Fiscal 2009 for approximately \$186 million in cash. Dell recorded approximately \$133 million of goodwill and approximately \$63 million of purchased intangibles related to these acquisitions. The larger of these transactions was the purchase of MessageOne, Inc., for approximately \$155 million in cash plus an additional \$10 million to be used for management retention. MessageOne has been integrated into Dell's Global Services organization, and The

Networked Storage Company has been integrated into Dell's Europe, Middle East, and Africa (EMEA) Commercial segment. With these acquisitions, Dell expects to be able to broaden its services offerings to customers.

The acquisition of MessageOne was identified and acknowledged by Dell's Board of Directors as a related party transaction because Michael Dell and his family held indirect ownership interests in MessageOne. Consequently, Dell's Board directed management to implement a series of measures designed to ensure that the transactions was considered, analyzed, negotiated, and approved objectively and independent of any control or influence from the related parties.

Dell has recorded all of its acquisitions using the purchase method of accounting in accordance with SFAS No. 141, *Business Combinations* (SFAS 141). Accordingly, the results of operations of the acquired companies have been included in Dell's consolidated results since the date of each acquisition. Dell allocates the purchase price of its acquisitions to the tangible assets, liabilities, and intangible assets acquired, which include in-process research &

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development (IPR&D) charges, based on their estimated fair values. The excess of the purchase price over the fair value of the identified assets and liabilities has been recorded as goodwill. The fair value assigned to the assets acquired is based on valuations using management's estimates and assumptions. Dell does not expect the majority of goodwill related to these acquisitions to be deductible for tax purposes. Dell has not presented pro forma results of operations because these acquisitions are not material to Dell's consolidated results of operations, financial position or cash flows on either an individual or an aggregate basis.

NOTE 8 WARRANTY LIABILITY AND RELATED DEFERRED SERVICE REVENUE

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. Dell records warranty liabilities at the time of sale for the estimated costs that may be incurred under its limited warranty. Changes in Dell's deferred revenue for extended warranties, and warranty liability for standard warranties which are included in other current and non-current liabilities on Dell's Condensed Consolidated Statements of Financial Position, are presented in the following tables:

	Three Months Ended	
	May 2,	May 4,
	2008	2007
	(in millions)	
<i>Deferred service revenue:</i>		
Deferred service revenue at beginning of period	\$ 5,260	\$ 4,221
Revenue deferred for new extended warranty and service contracts sold	952	824
Revenue recognized	(788)	(637)
Deferred service revenue at end of period	\$ 5,424	\$ 4,408
Current portion	\$ 2,518	\$ 2,033
Non-current portion	2,906	2,375
Deferred service revenue at end of period	\$ 5,424	\$ 4,408

	Three Months Ended	
	May 2,	May 4,
	2008	2007
	(in millions)	
<i>Warranty liability:</i>		
Warranty liability at beginning of period	\$ 929	\$ 958

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Costs accrued for new warranty contracts and changes in estimates for pre-existing warranties ^(a)		352	252
Service obligations honored		(267)	(321)
Warranty liability at end of period	\$	1,014	\$ 889
Current portion	\$	677	\$ 638
Non-current portion		337	251
Warranty liability at end of period	\$	1,014	\$ 889

(a) Changes in cost estimates related to pre-existing warranties are aggregated with accruals for new warranty contracts. Dell's warranty liability process does not differentiate between estimates made for pre-existing warranties and new warranty obligations.

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