Dividend Recapitalization: Is Icahn right on Dell?

Dell is in the midst of a fight between three investor groups. One is led by Michael Dell and funded by a private equity partner. The second is the Blackstone counter offer for the firm. The third is a bid by Carl Icahn. All three groups are pushing for more debt in the firm, but the Icahn bid is different on two dimensions: one is that it wants to keep the firm public (while the other two plan to take it private) and it wants Dell to pay much of the new debt out as a special dividend (rather than try to restructure the firm).

I have two articles attached to this weekly puzzle. One is on the Dell dividend recap proposal by Icahn and the other is on a surge in dividend recaps in Europe, primarily in companies that have been taken private by PE firms.

I have also attached the financial summary page for Dell and my assessment of the optimal capital structure for Dell. Based on the operating income that Dell reported in the last twelve months, the optimal debt to capital ratio I come up with 50%. Note that the debt ratio for Dell, based on the plans of all three groups, will be in the 60%-70% range.

1. Do you think that Dell is a good candidate for an increase in financial leverage? If yes, why? If not, why not?
2. Which of the three group's proposals is closest in spirit and practice to what we assume in the optimal capital structure spreadsheet (about what the firm does with the "new" debt)?
3. If you believe that value will increase by increasing debt, what is driving the increase in value? (I know that you are tempted to say the "lower cost of capital" but what is causing the cost of capital to be lower?)
4. If you were a potential lender to Dell on this deal, why would you lend money? And assuming that you lend money, how would you try to protect yourself?