

24/7 Wall St., LLC  
**SPECIAL SITUATION INVESTING NEWSLETTER**



Insightful Analysis and Commentary  
for U.S. and Global Equity Investors

August 14, 2007

**“The Highly Awaited EMC Partial Spin-Off and IPO of VMware  
Finally Comes To Market”**

Last night, we got the long awaited partial spin-off IPO pricing of EMC Corp.’s (EMC) virtualization unit VMware (VMW). VMware priced 33 million shares at \$29.00, at the top of its revised-higher \$27.00 to \$29.00 range, but \$1.00 or more short of our \$30.00+ pricing objective. Go ahead and just assume there will be that 4.95 million shares from the overallotment option. Citigroup, JPMorgan and Lehman Brothers acted as the representatives of the underwriters and, together with Credit Suisse, Merrill Lynch & Co. and Deutsche Bank Securities, acted as the joint book-running managers of the offering. This offering is raising \$957 million in the sale, but with the overallotment we would expect the true amount before fees of \$1.10055 Billion.

First off, we want to be quite clear, that our main comparison of this spin-off is quite similar to the 3COM (COMS) spin-off of Palm (PALM) in early 2000. There are other comparisons that have been made available so this is not an ‘only one’ scenario. We think this could see a fraction of the profit taking that was exhibited in the COMS-PALM deal in 2000, although this is more so on a trade rather than based on a longer-term investing scenario. COMS-PALM both never saw their old prices from the opening day, and we do not expect this to be the case.

A ‘sell the news’ seems most likely in the cards, despite the myriad of analysts that have been calling for this as a trade ahead of the event. But we do not expect even a 15% or 20% drop on EMC. A drop of that magnitude would create what we feel is a buying opportunity. Both of these companies are going to have a core following after today’s spin-off is completed. That of course bars any major unexpected developments. The good news is that after the 7.5% pop in EMC yesterday and the almost 2% gap-up in early pre-market trading, we feel the scenario is setting up as we’d expect for a sell the news on the event.

At the very end we have comprised a set of different scenarios for traders that can utilize options trading. We set out the trade possibilities for both bulls and bears that want to be mildly aggressive all the way up to trade scenarios that want to be wildly aggressive. Until this deal priced, all prices were mere speculation. Actually, until you have formal VMware stock indications, this is still guesswork.

**VMWARE ITSELF**

It is hard to know where VMware will open with 2 hours to go until the open. If this sees a major gap-up then we’d think holding off may be the best strategy. That would be true even if it means you pay a higher price down the road. This has NO trading history of its own, and that must be factored in. If VMware opens at \$30.00 or \$35.00 then there may still be some room on the hype alone. Just keep in mind that the valuation at \$30.00 was already in the \$10 Billion market cap neighborhood with only 13% of the stock even available for trading in the public. If this gaps north of \$40.00 you are on your own, and if this hits

[WWW.247WALLST.COM](http://WWW.247WALLST.COM)

the theoretical price of \$60.00 that Jim Cramer threw out there on TheStreet.com then you aren't only on your own: you are venturing back into bubble-days valuations.

So after the debut, you can expect some funds to hold VMware shares and this will give it a tiny actual float. This will in and of itself create exacerbated moves, and will make much of the moves after today even less predictable and sets up the possibility to throw rationality out the window.

## **HOW TO VIEW THE STRUCTURE**

After the IPO EMC will own 87% of VMware. For starters, I am going to use a phrase here that some of you will hate. VMware is essentially a tracking stock, just like Time Warner Cable is now the cable-tracker for Time Warner Inc. with 16% of 'Cable' having come public as part of that old Adelphia creditor pact. This is also just like the old tracking stock models like "Sprint PCS" and "AT&T Wireless" from so long ago. Hughes was a tracking stock from GM, and DLJ even spun-off its DLJ Direct in a tracking stock. We could be nicer and call it a carve out or an under-control subsidiary, but we feel it is what it is.

Before you crucify 24/7 Wall St. for using the term 'tracking stock,' don't take it as a bad sign or an omen. Some of the above tracking stocks did incredibly well even if they are not an assured success. EMC has indicated that it is going to hoard shares, and this Class B stock with higher voting rights basically leaves 98% of the votes of VMware actions staying with EMC even after the IPO.

### **PALM'S DEBUT & COMPARISON TO VMWARE:**

Price range went from \$14.00-16.00 range up to \$30.00-32.00, and priced at \$38.00. This was part of the reasoning that we thought that VMware would hit a \$30.00+ pricing. PALM priced at \$38.00, then OPENED on MARCH 2, 2000 at \$145.00, rapidly hit \$165.00 as the opening day high, and then closed down close to \$95.00 all on opening day. By March 6, 2000 shares were under \$65.00, and shares even closed under \$50.00 on March 21, 2000.

### **THE 3COM COMPARISON TO EMC:**

3Com (COMS) signaled the spin-off in September 1999, so we'll give a playbook of what happened. 3Com closed at \$28.50 per share on September 15, 1999. On January 3, 2000 shares closed at \$48.81. On February 15, 2000 shares closed at \$70.00. On March 1, 2000 shares closed at \$104.12 after hitting intraday highs of \$119.75. On March 2, 2000 shares opened up at \$117.00, traded as high as \$117.27, and closed all the way down at 81.81. At the close on March 6, 2000 shares were at \$69.56. On March 21, 2000 shares closed at \$64.11, and had even traded as low as under \$55.00 on March 14, 2000.

### **WHAT WAS NASDAQ DOING WAY BACK WHEN?**

Please understand that this was the absolute crest of the dot.com bubble seeing a major burst, and the market played a huge role in the plummet of the share price. On March 2, 2000 the NASDAQ closed at 4,754.51 (a week before 5,000+ highs) and it had dropped down to 4,711.68 on March 21, 2000 (and back down to under 4,000 in April).

Palm also had pledges from America Online, Motorola, and Nokia to take small stakes in the company. Does this remind you of Intel and Cisco owning small stakes in VMware? Palm had a market cap north of \$50 Billion at one point and 3COM had reached \$28.6 Billion after the spin-off. At the end of 1997 PALM had 220 employees, and that grew to 652 workers at end of 1999. 3COM spun off the bulk of the PALM shares later on in 2000.

### **OTHER DEALS IN THE PAST**

Oracle spun off its partially owned set-top box software player Liberate, and Oracle did maintain a stake of roughly half for a while.

Microsoft spun off online travel site Expedia, and Microsoft initially kept 86% of the shares. Its original spin-off IPO was only going to be valued at a fraction of the \$8+ Billion market cap of today.

Hewlett-Packard spun off Agilent and for some time held 85% of the offering in 1999. Agilent originally went from under \$50.00 to a very very brief ride over \$150.00 in early 2000, and was under its debut price by the following summer. Shares made a couple brief runs in 2000 but sank close to as low as under \$15.00 in 2002 and have gotten back to \$36.33 as of Monday.

AT&T spun out Lucent in the mid-1990's, and then Lucent spun out Agere in 2001.

So you can see some major name deals have occurred. Some did great, some did not. The common theme throughout these is that the carve-out company is eventually either jettisoned entirely or it becomes part of the parent or another company. By the sound of how EMC has portrayed the interest, VMware is probably going to be under the EMC thumb for quite some time. Only time will tell how long that really is.

#### KEY RECENT ANALYST CALLS & CHART DATA ON EMC:

Last week Morgan Keegan raised the rating to an Outperform. Early this month, Goldman Sachs raised the EMC rating by raising the target to \$22.00 and putting EMC on the Conviction Buy List. A.G. Edwards has a Buy rating. Thomas Weisel has had an overweight rating. There are now targets above \$20.00 longer-term on EMC, and just last night Jim Cramer said this wasn't too late to get in on before it goes to \$23.00.

Because of the incredible stock performance, it would seem as though this one still has a longer-term up trend in place. This is true on a much longer-term basis, but the recent market malaise created some technical damage to the wildly bullish chart scenario. Ultimately EMC has the shot of breaking out again, but there is going to be some proving ground here. Here is the chart, courtesy of BigCharts.Com:



#### EMC'S STOCK PERFORMANCE INTO THIS IPO:

On February 7, 2007, EMC announced that it was unlocking the VMware unit. Shares closed up about 6.6% at \$14.50 on the day after this announcement came late on the 7th. Shares actually traded a bit lower after this and went back down to under \$13.00 briefly in March, but had surpassed \$15.00 by mid-April. On May 23, it had its first close above \$16.00 for some time, and reached \$17.00 on May 30. It then closed above \$18.00 on June 29 and above \$19.00 on July 12. On July 19, it reached an Orwellian high of \$19.84, and closed at \$19.72. Those highs have not really been seen since, but the 7.5% gain Monday to \$19.05

and then the 1.4% rise in after-hours to \$19.32 has it likely within a few percentage points of those highs. These recent highs are 5+ year highs and take the stock back to pre 9-11-2001 highs. Shares spent a year from 2002 to part of 2003 in the sub-\$10.00 areas, and shares even briefly traded under the \$5.00 hurdle.

## **OPTIONS SET-UP STRATEGIES & EMC PLAYBOOK**

The good news is that the AUG-2007 puts and calls expire this coming Friday, so the time value is minimal. Due to the demand of this VMware partial spin-off in an IPO there is still quite a large following in the options. As you can see the "at the money" and the "slightly out of the money" options have the most contracts listed in the open interest for AUGUST because they are the cheapest. You will also see that the bias leans on the same direction away from the closest strike prices (Up \$1 from the \$19 Calls, and down \$1 from the \$19 Puts) that the open interest (OI) is heavily biased toward the call options. This means that the bets for the stock to go up have already been made. The AUGUST OI for the Calls to Puts are almost 3-1; the SEPTEMBER OI for the Calls to Puts are almost 4-1; and the OCTOBER OI for the Calls to Puts is over 3.5-1.

This data is based on the MONDAY close, so the prices and even the open interest will be different at the open of the options trading Tuesday. The time value compression will eat a bit (in theory) of the AUGUST premiums, but there is still enough time for the September and October contracts to not make that much of a price difference compared to the AUGUST options that expire this coming Friday. Here is the options data from yesterday (MONTH, Strike, Monday closing price, OI-Open Interest):

AUGUST-2007 CALLS  
\$19.00 \$0.65; 77,873 OI  
\$20.00 \$0.35; 70,911 OI

AUGUST-2007 PUTS  
\$18.00 \$0.25; 22,623 OI  
\$19.00 \$0.55; 28,589 OI

SEPT-2007 CALLS  
\$19.00 \$1.40; 10,532 OI  
\$20.00 \$0.95; 15,073 OI

SEPT-2007 PUTS  
\$18.00 \$0.75; 3,407 OI  
\$19.00 \$1.24; 3,292 OI

OCT-2007 CALLS  
\$19.00 \$1.70; 20,346 OI  
\$20.00 \$1.25; 46,798 OI

OCT-2007 PUTS  
\$18.00 \$1.05; 9,995 OI  
\$19.00 \$1.45; 8,436 OI

We believe that you could most likely see some selling of the news, although because of an underlying base cost being under \$20.00 we would caution against being as aggressive as some traders were in the 3COM/PALM spin-off. The truth is that this time seems different. But this play has been seen before. Below are some scenarios, and usually this has to be accomplished within minutes of the spin-off opening for trading. That should be within the first 20 or 30 minutes since it is NYSE listed.

### ***Bullish Scenarios***

OPTION ONLY SPECULATION: Buy Call options only

MILDLY BULLISH CALL: Buy Stock only

VERY BULLISH CALL: Buy Stock and Buy Call Options

[WWW.247WALLST.COM](http://WWW.247WALLST.COM)

WILDLY BULLISH CALL: Buy Stock, Sell Puts & Buy Calls

***Bearish Scenarios***

OPTION ONLY SPECULATION: Buy Put options only

MILDLY BEARISH CALL: Short Sell Stock only

VERY BEARISH CALL: Short Sell Stock and Buy Put Options

WILDLY BEARISH CALL: Short Sell Stock, Sell Calls & Buy Puts

Again, we would expect a 'sell the news' reaction in EMC shares, although there is no way to assure that. Analysts are likely going to be out positively on both stocks today and you could easily see some wildly high price targets issued on one or both companies. Remember this is essentially no different than an old tracking stock, and this has been seen many times over.

**EMC & VMWARE "SELF DESCRIPTION" (CONSOLIDATED):**

We are the leading provider of virtualization solutions. Our virtualization solutions represent a pioneering approach to computing that separates the operating system and application software from the underlying hardware to achieve significant improvements in efficiency, availability, flexibility and manageability. Our solutions enable organizations to aggregate multiple servers, storage infrastructure and networks together into shared pools of capacity that can be allocated dynamically, securely and reliably to applications as needed, increasing hardware utilization and reducing spending. We believe that the market opportunity for our virtualization solutions is large and expanding, with 24.6 million x86 servers and 489.7 million business client PCs installed worldwide as of December 2006. Our customer base includes 100% of the Fortune 100 and over 84% of the Fortune 1,000. Our customer base for our server solutions has grown to include 20,000 organizations of all sizes across numerous industries. We believe our solutions deliver significant economic value for customers, and many have adopted our solutions as the strategic and architectural foundation for their future computing initiatives.

In the eight years since the introduction of our first virtualization platform, we have expanded our offering with virtual infrastructure automation and management products to address distributed and heterogeneous infrastructure challenges such as system recoverability and reliability, backup and recovery, resource provisioning and management, capacity and performance management and desktop security. We work closely with over 200 technology partners, including leading server, processor, storage, networking and software vendors. We have developed a multi-channel distribution model to expand our presence and reach various segments of the market. We derive a significant majority of our revenues from our large indirect sales channel of more than 4,000 channel partners that include distributors, resellers, x86 system vendors and systems integrators.

We have achieved strong financial performance to date, as demonstrated by our revenue growth. Our total revenues were \$703.9 million in 2006 and \$387.1 million in 2005, representing an increase of 82% in 2006. Software license revenues were \$491.9 million in 2006 and \$287.0 million in 2005, representing an increase of 71% in 2006.

Jon C. Ogg  
August 14, 2007

**DISCLAIMER:** All information has been taken from sources deemed reliable, but there can be no assurances that any of the claims or figures are 100% accurate. It is the responsibility of each individual to verify all data, and this should be used for informational purposes only. This is no way a recommendation to buy or sell securities and should not be regarded as investment advice. All data and any trading strategies should be considered with your own financial consultant.

**DISCLOSURES:** The writer of this document and officers of 24/7 Wall St., LLC hold NO equity positions and hold NO derivatives of securities in any of the companies mentioned herein.

**24/7 Wall St., LLC  
16 East 90th Street  
New York, NY 10128  
Tel. (212) 203-0673  
Fax (888) 633-0673**

[WWW.247WALLST.COM](http://WWW.247WALLST.COM)