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HP, Inc. (HPQ)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day everyone and welcome to the fourth quarter 2019 HP Inc. earnings conference call. My name is Gary, and I'll be your conference moderator for today's call. At this time all participants will be in listen-only mode. We will be facilitating a question-and-answer session toward the end of the conference. [Operator Instructions]

I would now like to turn the call over to Beth Howe, Head of Investor Relations. Please go ahead.

Beth Howe

Head-Investor Relations, HP, Inc.

Good afternoon. I'm Beth Howe, Head of Investor Relations for HP Inc. And I'd like to welcome you to the fiscal 2019 fourth quarter earnings conference call with Enrique Lores, HP's President and Chief Executive Officer and Steve Fieler, HP's Chief Financial Officer.

Before handing the call over to Enrique, let me remind you that this call is being webcast. A replay of the webcast will be made available on our website shortly after the call for approximately one year. We posted the earnings release and the accompanying slide presentation on our Investor Relations website at investor.hp.com.

As always, elements of this presentation are forward-looking and are based on our best view of the world and our businesses as we see them today. For more detailed information, please see disclaimers in the earnings materials relating to forward-looking statements that involve risks, uncertainties and assumptions. For a discussion of some of these risks, uncertainties and assumptions please refer to HP's SEC reports including our

most recent form 10-K and form 10-Q. HP assumes no obligation and does not intend to update any such forward-looking statements. We also note that the financial information discussed on this call reflects the estimates based on information available now and could differ materially from the amount ultimately reported in HP's form 10-K for the fiscal year ended October 31, 2019 and HP's other SEC filings.

During this webcast, unless otherwise specifically noted, all comparisons are year-over-year comparisons with a corresponding year-ago period. For financial information that has been expressed on a non-GAAP basis we've included reconciliations to the comparable GAAP information. Please refer to the tables and slide presentation accompanying today's earnings release for those reconciliations.

And now I'll turn it over to Enrique.

Enrique Lores

President, Chief Executive Officer & Director, HP, Inc.

Thank you, Beth, and thank you for joining us today. HP delivered another strong earnings quarter reflecting the strength of our innovation and execution, the progress we're making against our strategic priorities, and the multiple value creation engines across our company.

In Q4, we grew revenue 2% in constant currency. We grew non-GAAP operating profit dollars 5% and we delivered non-GAAP EPS of \$0.60, an increase of 11% and above our guided range. This represents the ninth consecutive quarter where we have grown revenue, non-GAAP OP dollar and non-GAAP EPS.

The fourth quarter capped off a very solid year in which we exceeded our target for non-GAAP EPS growth and free cash flow. Our strategy is working and we are confident about our business outlook heading into fiscal year 2020.

For the full fiscal year 2019, we grew revenue 2% in constant currency, our third consecutive year of growth. We grew non-GAAP EPS 11% with double-digit increases for the last two years. We generated \$4 billion in free cash flow, above our full year outlook, and we returned 85% of that to shareholders through share repurchases and dividends.

We continue to lead in our core market with strong disciplined execution, finishing the year, shipping one in every four PC unit and two out of every five printer. These results demonstrate that we have multiple levels to drive operating profit dollars and create shareholder value. And I want to be very clear. Our focus remains on creating value for all of our shareholders and delivering for our customers, partners and employees. I have great confidence in the strategy that we shared at our Securities Analyst Meeting. It is confirmed by the progress we have already started to make in the five key strategic moves I laid out.

Let me recap each of them and share initial examples of the progress we are making. The first move is implementing a new operating model and driving digital transformation. On November 1, we went live with our new operating model and the creation of a single commercial organization to simplify our go-to-market structure. We have taken out the regional layer of the organization. This helps us to reduce costs, accelerate decision-making, and be closer to customers. We have also introduced a new business management system to streamline accountability.

Second, we are delivering new compute experience. HP is delivering the best innovation in the market. Recently, we launched our lightest commercial notebook, the Elite Dragonfly, with an ultra-bright screen and HP Sure View privacy, this device is purpose-built for the mobile workforce, which demands flexibility to work anywhere. It is also

the world's first laptop made using ocean-bound plastic, reflecting our continued commitment to environmental sustainability. It's another example of how we continued to set new standards in the PC category.

In addition, we continued to strengthen our commitment to security with acquisition of Bromium, an innovator in endpoint security. Our belief is that every device decision is a security decision, with Bromium, we will be able to provide comprehensive protection against the most sophisticated malware and enhance our firmware and BIOS security layer.

Third, we are evolving Print business model. Our contractual business continued to grow with MPS and Instant Ink, it's up double digit, and with over 5 million subscribers, the momentum in Instant Ink continues to build. At the same time, our big ink and big toner products extended the rollout, launching in Latin America and Central Europe. Importantly, the new transactional business model we introduced at SAM with Office customers either are flexible or a full end-to-end HP system is on track to launch new products by the end of fiscal year 2020. And remember, this model will evolve over time.

Fourth, we are expanding our industrial businesses. In graphics, we see steady growth in pages printed. In fiscal year 2019, in 3D and digital manufacturing, we more than doubled the number of parts produced, with over 18 million final production parts across a widening range of applications. We remain on track to double the number of parts by the end of fiscal year 2020. And we just helped Volkswagen produce 10,000 precision metal parts in just a few weeks to support the launch of their ID.3 electric vehicle.

And finally, we are executing on our restructuring. We have initiated a voluntary early retirement program in the United States, and the take rate increases my confidence in our ability to deliver on our savings goal.

Let me now make a few comments on our business segment performance. In Q4, Personal Systems delivered another strong performance of revenue, operating profit, and share growth. Revenue grew 5% in constant currency and operating profit increased 48%. This result reinforces the strength of our innovation and disciplined execution against our strategy. We continued to outperform the PC market, with broad-based growth across all regions and product categories. In calendar Q3, we grew faster than our competitors, gaining 1.2 points of share. While we are proud of these results, share gain continues to be an outcome, not an objective. We are delivering these results despite the ongoing industry constraints on CPU capacity, which are now expected to continue into the first half of 2020 and to be more impactful in Q1.

Turning to Print, we continue to execute our strategy. In Q4, total revenue declined 5% in constant currency. As we have anticipated, Supplies revenue remained soft. We are executing against both the operational and strategic plans we laid out in prior quarter. And as we said, into fiscal year 2020, we expect our new commercial organization will drive better global best practices and consistency in Supplies execution. In fact, elements of the design and implementation of the new commercial organization are expressly focused on addressing some of the operational issues and leadership changes in EMEA.

As always, maximizing the value of our installed base is a core objective. We are driving preference for HP Original Supplies with targeted marketing campaigns that ensures that customers understand the quality, sustainability, and security benefits of HP Original Supplies compared to the alternative. We expect the combination of these actions to show improvement as we get further into fiscal year 2020 and we remain focused on maximizing the value of our installed base.

In Graphics, we recently closed another key win with ePac Flexible Packaging for an additional 24 HP Indigo digital presses as they continue the disruption of the global flexible packaging market.

Looking at 3D and digital manufacturing, we finished the year strong. Our business continues to grow, and the market acceptance of our new industrial 5200 solution has been positive. We are expanding our alliance ecosystem and building in production applications across key verticals, including automotive, industrial, consumer, and healthcare. I am pleased with our progress and look forward to delivering even more disruptive solutions in fiscal year 2020.

In closing, we delivered another good quarter, demonstrating our track record of execution. These results and the progress we are making give me confidence in our strategy and the upside opportunities HP has for even greater value creation. Our plans to advance, disrupt, and transform provide us with three powerful engines of value creation and support a clear and compelling investment thesis. We believe that the powerful combination of our scale, channel reach, and incredible brand combined with our track record of execution and innovation will create significant value for our customers and our shareholders.

Now, before I turn the call over to Steve, let me note that we will not be expanding on our previous public comments with regard to Xerox proposal. Accordingly, we ask that you please keep your questions focused on the business and our results during the Q&A portion of this call, as we will not be commenting on Xerox or its proposal.

Now, I will turn it over to Steve to go through more details and provide our financial outlook.

Steven Fieler

Chief Financial Officer, HP, Inc.

Thanks, Enrique.

Q4 was a solid finish to FY 2019, where we once again demonstrated our ability to consistently deliver company results, posting growth in revenue, non-GAAP operating profit and EPS.

Before diving further into Q4, let me quickly recap FY 2019 for the full year. We grew revenue, we grew non-GAAP operating profit dollars faster than revenue and we grew non-GAAP EPS even faster. These results show the strength of our financial model. For the full year, constant currency revenue was up 2%. Non-GAAP operating profit dollars grew 3% with operating margin rate expansion in both Print and Personal Systems. Print grew margins by 10 basis points to 16% while PS grew 120 basis points to 4.9%, both within our guided ranges. We delivered non-GAAP EPS of \$2.24, an increase of 11% and above our guided range.

We generated \$4 billion of free cash flow, ahead of our full year outlook of least \$3.7 billion, and we returned \$3.4 billion or 85% of free cash flow to shareholders. Importantly, we delivered these results while investing in our business for future growth and efficiency opportunities. Our foundation is strong, including our balance sheet and we have multiple levers to create value for our shareholders. This is what we said at our Securities Analyst Meeting and this is what we intend to do. Overall, we are pleased with our full year results despite more challenging industry, macroeconomic and geopolitical dynamics.

Now let's look at the details of the fourth quarter. Net revenue was \$15.4 billion, flat year-on-year, or up 2% in constant currency. Regionally, in constant currency, APJ grew 7%, Americas grew 1% and EMEA was flat. Gross margin was 19%, up 1.4 percentage point year-on-year, driven primarily by disciplined execution and improved rate in Personal Systems as well as improved rate in Print supported by higher hardware gross margin.

Non-GAAP operating expenses were \$1.8 billion, up 11%, driven by increased investments for both growth and efficiency, including investments to drive future revenue and innovation as well as investments in HP's digital transformation. Non-GAAP net OI&E expense was \$60 million for the quarter. We delivered non-GAAP diluted net earnings per share of \$0.60, up \$0.06 or 11% with a diluted share count of approximately 1.5 billion shares.

Non-GAAP diluted net earnings per share excludes amortization of intangible assets of \$21 million, acquisition-related charges of \$21 million, restructuring and other charges of \$105 million, as well as non-operating retirement-related credits of \$14 million. It also excludes a net expense of \$378 million for tax adjustments. This net expense is primarily driven by the termination of our Tax Matters Agreement with Hewlett Packard Enterprise, partially offset by other tax adjustments. As a result, Q4 GAAP diluted net earnings per share was \$0.26.

At the segment level, in Personal Systems we are again very pleased with our results. Revenue in the fourth quarter was \$10.4 billion, up 4% or 5% in constant currency. By customer segment, Commercial revenue was up 8% and Consumer revenue was down 4%. By product category, revenue was up 12% for Workstations, up 5% for Desktops and up 2% for Notebooks. The team continued to successfully manage our overall product mix, as commercial demand remained strong while navigating a softer consumer market.

Personal Systems has been consistently delivering profitable growth and share gains over time. HP outgrew the market in calendar quarter 3 with strong execution, HP-specific innovation and a focus on exceptional partner and end customer experiences. In addition, we see opportunities to improve our portfolio mix over time in areas of premium displays and accessories, and services. For example, this quarter, our revenue in retail solutions business and gaming, along with our services orders, all grew double digits. Q4 operating margins remained exceptionally strong at 5.3%, up 1.6 point year-on-year. The large increase was driven mainly by the team's continued execution of our strategy, balancing the industry's various puts and takes and remaining disciplined in a favorable commodity cost environment. Operating profit was \$556 million, up 48% from the prior year.

In Print, the business performed generally in line with our expectations for the quarter. We continued to deliver leading customer experiences, made progress in our contractual offerings, incrementally shift more profit to hardware and addressed our near-term operational challenges in EMEA. Looking at the details, Q4 total Print revenue was \$5 billion, down 6% nominally and 5% in constant currency. Our operating margins were down 0.4 point to 15.6% due to lower Supplies revenue.

Commercial hardware revenue was down 2%, and Consumer hardware revenue was down 10%. Total hardware units were down 9%, driven by declines in Consumer units, which were down 10% with Commercial units down 1%. Fourth quarter Supplies revenue was \$3.2 billion, down 7% in constant currency, again driven by declines in EMEA. We are making progress on our operational improvement plans, and we've seen a significant reduction in Tier 1 and monitored Tier 2 channel inventory dollars in EMEA throughout the year. Overall, Tier 1 channel inventory levels remained below the reduced ceilings.

We continue to make progress on our strategic plans to evolve our business models. We're seeing success in contractual as we grew both Managed Print Services and Instant Ink this quarter. Importantly, we remained under-indexed in contractual and are pleased that we continued to outgrow the market.

Let me now turn to our transformation efforts and specifically our cost-savings opportunities. At SAM, we described our plans to generate approximately \$1 billion of gross run rate savings by the end of FY 2022 and that we're continue looking for more opportunities. In Q4, we announced a voluntary early retirement program in the United States. More than 1,000 participants have opted into the plan, which will be effective through the course of the year. This take rate adds to our confidence in delivering both the FY 2020 and overall plan savings targets.

Turning to cash flow and capital allocation. Q4 cash flow from operations and free cash flow were \$588 million and \$392 million respectively. We generated \$4 billion in free cash flow for the full year. In Q4, the cash conversion cycle was minus 31 days. Sequentially, the cash conversion cycle declined 5 days in line with normal seasonality with a 6-day decrease in days payable outstanding, a 2-day increase in day sales outstanding and a 3-day decrease in days of inventory. We've returned \$461 million to shareholders through share repurchases and \$236 million via cash dividends in Q4. For the full year, we returned \$2.4 billion to shareholders through share repurchases and \$1 billion via cash dividends.

Looking forward to Q1 and FY 2020, keep the following in mind related to our overall financial outlook. We expect that the macroeconomic conditions will remain dynamic, as they are today, and we expect our end markets to remain competitive. We're expecting currency to have about a 1% year-over-year negative impact. Specific to Personal Systems, we expect commodities to be significantly less of a tailwind in FY 2020 than in FY 2019 especially in the second half. We now expect industry-wide CPU supply constraints to persist through the first half of 2020. In Q1 specifically, we're anticipating a larger revenue impact than in Q4; however, we expect our mix to shift to more profitable units, which should largely mitigate the profit impact.

In Printing, we're assuming a year-over-year unit market decline driven by the home market. As a reminder, we are deliberately not chasing share, especially as we raise hardware pricing and focus on profitable growth. As described at SAM, as we progress through the year, we expect the net benefits of our transformation cost-savings and other operational changes to begin to materialize. In addition, for the full year, we expect our non-GAAP tax rate, which is based on our long-term non-GAAP financial projection, to be 16% in FY 2020. Consistent to what we communicated in October, we expect to return at least 75% of free cash flow to shareholders in FY 2020 as we view our shares as significantly undervalued.

Taking these considerations into account, we are providing the following outlook. Q1 2020 non-GAAP diluted net earnings per share to be in the range of \$0.53 to \$0.56. Q1 2020 GAAP diluted net earnings per share to be in the range of \$0.39 to \$0.42. We are raising our full year fiscal 2020 non-GAAP diluted net earnings per share to be in the range of \$2.24 to \$2.32 and full year fiscal 2020 GAAP diluted net earnings per share to be in the range of \$2 to \$2.10.

Operator, we can now open the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. And we will now begin the question and answer session. [Operator Instructions] And our first questioner today will be Amit Daryanani with Evercore. Please go ahead.

Amit Daryanani

Analyst, Evercore Group LLC

Q

Thanks a lot, guys. I have a question and a follow-up. The first one, I guess, on Supplies, Enrique, I don't want to use the word stabilize but we've been down 7% I think for couple of quarters in a row now. Do you think we're starting to hit a bottom over here? And how should we think about the Supplies trajectory as we go through fiscal 2020? And any feedback you have had from your customers or suppliers, I guess, broadly in terms of the business model transition and the preference they have over here?

Enrique Lores

President, Chief Executive Officer & Director, HP, Inc.

A

Sure. So first let me try to frame the problem that we are facing in Supplies, and then Steve will provide some more data about what we see happening in the future.

As we have shared in the past, we have two challenges on the Supplies side. First, we have what we call a strategic challenge, driven by the growth of clones because of the lower pricing and the access that they have to the online space. But we also have an operational challenge in EMEA, driven by the low visibility we've had of some inventory in their unmonitored channel combined with the aggressiveness of the clone competition. And we are making good progress addressing both problems.

On the strategy side, we announced our plan in the Securities Analyst Meeting to transform our model by evolving into services, accelerating the growth in big ink and big toner in emerging countries, and at the end of next year starting to evolve our transactional model into both an end-to-end or a flexible model.

On the operational side, we have also made good progress, reducing our inventory, accelerating our growth online, getting better visibility of the inventory in Tier 2s, and as we said in the prepared remarks, changing our control processes to make sure that we have better business management processes in EMEA. Steve?

Steven Fielor

Chief Financial Officer, HP, Inc.

A

I think just to start, as I've said many times, our focus remains on operating profit dollars across the entire Print ecosystem. But as it relates specifically to Supplies, Enrique mentioned operationally making good progress. We're seeing good indicators. Strategically we're taking the right long-term steps.

Q1 specifically, I guess what I'd say is we're planning prudently. Therefore, we're planning Q1 to be more in the range of where we were in Q4, and that's embedded in our outlook, and have confidence in the plan. Through the remainder of 2020, there are things that we view as tailwinds. We're shifting more of our business to contractual-based models, and that's across both home and office, and so that's stickier higher share revenue for us. We expect to continue to grow our industrial businesses across graphics and 3D. And as Enrique mentioned, we're making the right operational changes in EMEA but also globally with the new commercial organization.

Obviously, we have some offsets. As you're aware, we have declines in the installed base in home. We're very well aware of that and obviously need to mitigate those declines. And also the challenges we've discussed in prior quarters on the aftermarket share of Supplies. So we've got some pluses and minuses as we head through the rest of the year, and I guess that's how we view Supplies trajectory for FY 2020.

Amit Daryanani

Analyst, Evercore Group LLC

Q

Got it, that's really helpful. And I guess my follow-up, Steve, for you, \$4 billion free cash flow this year, extremely impressive. I think it was better than what you guys were targeting. Can you just maybe bridge this for me and everyone, \$4 billion in fiscal 2019 to \$3 billion in fiscal 2020, what are the puts and takes? And I'm assuming – and really to understand how much of the delta over the year is transitory in nature versus structural, that would be helpful.

Steven Fieler

Chief Financial Officer, HP, Inc.

A

Sure. So I've got a lot of confidence delivering at least \$3 billion, and that's our outlook for FY 2020. If you just look back over the past four years, we've averaged a little bit over \$3.5 billion each year, and this year in particular we do have a headwind primarily as it relates to restructuring of roughly \$400 million. As I mentioned at SAM, there are some other one-time favorabilities we saw in FY 2019 that we don't expect to repeat.

That being said, given where we ended cash conversion cycle in FY 2019, I would view CCC as actually a help year over year. Our outlook for FY 2020 is minus 33 days, and we finished FY 2019, it's minus 31. We'll need to see how the PS volume plays out in the second half. And I would note that the seasonality this year in PS may be different given some of the industry dynamics. But all together, I've got a high degree of confidence in delivering the at least \$3 billion on it.

Operator: The next question is from Shannon Cross with Cross Research. Please go ahead.

Shannon S. Cross

Analyst, Cross Research LLC

Q

Hi, thank you for taking my question. I know you talked – you said you won't talk about Xerox, so I won't ask that specifically. But in the conversations you've had back and forth in the letters, a couple of times there's been a mention of strong balance sheet and share repurchase. So I guess maybe can you take a minute to just talk about how you view your capital structure, uses of cash, and your thoughts on where investors are leaning or what the board is thinking these days? And then I have a follow-up. Thanks.

Steven Fieler

Chief Financial Officer, HP, Inc.

A

Thanks, Shannon. And maybe just for starters, I do want to repeat maybe some of my comments at SAM, and then talk about where we are. As you're aware, we did update our long-term return of capital target at our Securities Analyst Meeting to return approximately 75%. That's our long-term target, and really this is about a steady return profile for our investors and supporting our business strategy. For FY 2020 specifically, we're targeting at least 75% return. And we said at the time given our stock price significantly undervalued the business, and we have confidence in our outlook. We also indicated that our board approved an incremental \$5 billion share repurchase authorization, so we do have the flexibility to be opportunistic.

To bring it back up to I guess the point of your question around capital allocation, which we do view as an extremely critical management responsibility, in our framework we'll remain disciplined. We have evaluated – we'll continue to evaluate ways with our balance sheet to create additional shareholder value. That could include M&A. It could include additional return of capital. As always, we'll compare the options using return risk-adjusted view of each opportunity.

Enrique Lores

President, Chief Executive Officer & Director, HP, Inc.

A

And, Shannon, just let me emphasize the confidence we have in our plans. We explained our strategy during the Securities Analyst Meeting. We are making progress, and we are very confident in our ability to create value for shareholders, which is our key priority.

Shannon S. Cross

Analyst, Cross Research LLC

Q

Thanks. And maybe if you can talk about a bit about the A3 market, what you're seeing there, competition, and how some of your initiatives are going. Thank you.

Enrique Lores

President, Chief Executive Officer & Director, HP, Inc.

A

Sure. So, A3 is a key element of our contractual plans. And as I said in the prepared remarks, we are making very good progress. In a flat market, we are growing double digit. And if we focus for a second on A3, we have grown 5% where the market is barely flat, so very good progress. And I think this is really important because as we look at the future of the Print business and the need we have to change the opportunity we have to continue to expand and change the business model, growing in contractual is critical for us going forward. And this is really where our focus is and where really our focus will continue to be in the incoming quarters.

Operator: The next question is from Toni Sacconaghi with Bernstein. Please go ahead.

Antonio M. Sacconaghi Jr.

Analyst, Sanford C. Bernstein & Company

Q

Yes, thank you. I have a question and a follow-up as well. I was wondering if you could comment specifically on channel inventory over the course of this year. So specifically, if I were to look at this day a year ago versus today, how significant was your drawdown in channel inventory in terms of weeks? And what impact did that have on Supplies revenue growth this quarter – this year, excuse me, in fiscal 2019? And do you believe that Supplies revenue growth will be better in fiscal 2020 than 2019? And I'll do my follow-up after.

Steven Fieler

Chief Financial Officer, HP, Inc.

A

So I'm assuming this is about the Supplies channel inventory and not channel inventory broadly, so let me comment on where the Supplies channel inventory went this year. So throughout FY 2019, we have reduced our channel inventory dollars by over \$100 million. This is more than what we initially estimated, so we continue to make good progress. This includes both Tier 1 and parts of Tier 2. And note that we don't have complete visibility into entire ecosystem. And so things are getting better. We do know at the same time the EMEA market has softened, so it's hard to bifurcate or specifically quantify how much of that channel inventory reduction was a result of starting the year off in a high position versus what was happening in the marketplace, but you should sort of think about it as at least \$100 million channel inventory reduction on a year-over-year basis.

As I mentioned, as it relates to FY 2020, we do feel like there's things that are going our way from the contractual models, industrial businesses and the operational changes we've made. But we also have headwinds and so we have to manage through the headwinds around the home side, have to manage the headwinds around ensuring we're protecting our share as much as possible. So I think those are all factored into how we're thinking about FY 2020. We're taking a very prudent view and that prudent view is factored into not just our Q1 but our overall FY 2020 outlook.

Antonio M. Sacconaghi Jr.

Analyst, Sanford C. Bernstein & Company

Q

Okay. So no explicit comments on whether up or down relative to fiscal 2019 in terms of what's baked into your guidance, Steve?

Steven Fierler

Chief Financial Officer, HP, Inc.

A

As I said, I think we've got some headwinds, some tailwinds. What we're driving is operating profit dollars in our Print business. Obviously, Supplies is a big part of it but so is the shift more to Hardware. We saw our Hardware gross margins expand in Q4 as an example and adding more services to portfolios. So altogether, is what we're driving to focus on OP dollars versus just Supplies specifically.

Antonio M. Sacconaghi Jr.

Analyst, Sanford C. Bernstein & Company

Q

And then just to follow up, you've stated repeatedly on the call that you believe your shares are undervalued and that you outlined a highly credible strategy at SAM. But prior to the Xerox announcement, the stock has traded at \$17 or less since the Securities Analyst Meeting. And so I guess my question to you is what is it that you think you see that investors are missing given where the stock had traded at following SAM? And if you really were so confident that the stock has been structurally undervalued throughout the year, why did your SAM plan not include your deciding to take on debt and much more aggressively repurchased your shares?

Enrique Lores

President, Chief Executive Officer & Director, HP, Inc.

A

Let me start and then I think Steve will complement. I think that the key thing that we see, Toni, is the gap between the current value of the stock, but the net present value of the cash flow projections that we have in our plans. And this is what drives our comment on think – about being undervalued. What we have proven this quarter and what we have proven in the past is that we have a clear ability to execute and that we deliver on our commitment. And our expectation is that by executing every quarter and meeting our guidelines, we will be seeing that gap to be reduced.

Steven Fierler

Chief Financial Officer, HP, Inc.

A

And maybe just to add to that. What we did say at SAM, we did have a change in terms of our fiscal year 2020 return of capital, where we communicated that we expected to return at least 75%, and also announced an incremental authorization of share repurchase from the board of \$5 billion to give us the flexibility and opportunity to repurchase more shares. To note, in Q4, we did have additional material non-public information, I think that's obvious now, and so we were not as active in the market as we would have liked to have been.

Operator: The next question is from Katy Huberty with Morgan Stanley. Please go ahead.

Kathryn L. Huberty

Analyst, Morgan Stanley & Co. LLC

Q

Thank you. Good afternoon. How are you thinking about first quarter 2020 revenue performance versus normal seasonality, given the Intel comments about component constraints and your comments about not expecting an improvement in Supplies rate of decline? And then I have a follow-up.

Steven Fieler

Chief Financial Officer, HP, Inc.

A

Yeah. So we are assuming that the CPU supply will constrain our revenue in Q1. And if you think about it on a sequential basis, certainly in the Personal Systems business, we would expect to have declines from Q4 to Q1 above the normal seasonal patterns. That being said, while this is more of a revenue impact than profit impact for the quarter as we expect our mix should be better.

Kathryn L. Huberty

Analyst, Morgan Stanley & Co. LLC

Q

Okay. Then just thinking more broadly over the course of fiscal 2020, Steve, you had mentioned that you see the potential for different seasonality than in the past. How long are you expecting that the PC market strength associated with the Win 10 upgrade last? Does that continue well into the first half of the year? And how do you see seasonality falling off in the back half as customers complete those upgrades?

Enrique Lores

President, Chief Executive Officer & Director, HP, Inc.

A

Katy, I think the seasonality for next year is going to be impacted by the availability of CPUs. What we know now is that availability is going to be constrained for the first full half, and therefore it will be having an impact on the seasonality with the second and the first half. So this is something that you really should have in mind as you build the projections for next year.

Steven Fieler

Chief Financial Officer, HP, Inc.

A

And as it relates then to the Win 7/Win 10 refresh, it could be that these current supply constraints actually indeed help prolong the Win 10 refresh. And so there's a lot of dynamics going on and that's why I think seasonal patterns are likely to be affected both from a supply but also on the potential extension of the Win 10 refresh.

Operator: The next question is from Ananda Baruah with Loop Capital. Please go ahead.

Ananda Baruah

Analyst, Loop Capital Markets LLC

Q

Hi. Good afternoon. Thanks for taking my question. I have a question and a follow-up as well. Just sticking there, Steve, some of the distributors actually believe with regards to Win 10 in PC – PC Win 10 refresh that there's actually a long way to go for small and medium business customers, which is a meaningful part of your customer base. And not just chipset related but related to those folks that just kind of put off larger purchases, as long as they possibly can. Do you have enough visibility to agree with that view or disagree with that view? And then I have a follow-up as well. Thanks.

Steven Fieler

Chief Financial Officer, HP, Inc.

A

I think in general we would agree with that view. There's a large installed base with PCs more than four years old. And our assessment – we're a little over a third – about a third of which are still on Win 7. So there's an opportunity for upgrades. There's an opportunity for upgrades. We're seeing – and Alex described this at our analyst meeting that PCs are being used by this generation versus prior generations and they're also using them for specific experiences. So we see the TAM and our ability to gain share as a good opportunity, not to mention our ability to continue improving our mix. But the short of it is we still think that there's some life here on that Win 7 to Win 10 refresh that will extend.

Ananda Baruah

Analyst, Loop Capital Markets LLC

Q

Right. That's really...

Enrique Lores

President, Chief Executive Officer & Director, HP, Inc.

A

And let me refer this comment. I think the combination of our innovation and ability to execute have proven that have allowed us to grow faster than the market. And this is what we expect to continue to do going forward.

Ananda Baruah

Analyst, Loop Capital Markets LLC

Q

That's really helpful, guys. And just as a quick follow-up, you mentioned for Printing new models out by the end of fiscal – I think you actually said 2020. So could you clarify if that's fiscal 2020 or calendar 2020, new models for the printer model – new hardware for the new printer model, can you clarify if that's fiscal 2020 or calendar? And then just how does that fit in – I guess the broader question is, how does that fit into you guys being able to really make an impact with the business model shift waiting for those new models? Thanks.

Enrique Lores

President, Chief Executive Officer & Director, HP, Inc.

A

So let me start from the second question, and then I will go back to the details of the first. As we shared during SAM, the change of business model in Print is driven by three different vectors. First is a shift into services, both into Managed Print Services and Instant Ink. This offers a better value proposition to customers, and this is a change that we have been driving for some time in the past and where we are growing double digit.

Second element of the change is the growth in emerging countries of the big ink and big toner category. Big ink has been in the market for some time. We are growing and we are the only company that offers a big toner solution and we have continued the rollout of these solutions during the last months. And only the last part of the change is really driven by the new model for transactional customers. This new model, as you said, will be available in the market at the end of the year, during our calendar Q4.

Operator: The next question is from Matt Cabral with Credit Suisse. Please go ahead.

Matthew Cabral

Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you. Enrique, maybe to pick up on your last answer, you mentioned the initial rollout of big ink and big toner in other emerging markets. Just wondering if you could talk about what the initial customer and competitive

response has been so far, and just how you're thinking about the geographic rollout of that model more broadly across your portfolio?

Enrique Lores

President, Chief Executive Officer & Director, HP, Inc.

A

Sure, the reception has been positive. As I said before, big ink has been in the market for some time and we have been growing our share. Big toner is a category that we are creating, and we started the launch a few months ago and as we go into more countries, we continue to see the growth. Reception is very positive because in those countries usually consumption is high. We have lower share of original supplies. And therefore, for us, it's a better model and it's also a better model for our customers.

Matthew Cabral

Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks. And then, Steve, on Personal Systems, margins were once again above 5% in the quarter. Just wondering if you could bridge how much of the year-over-year improvement was the tailwinds from component pricing versus just other underlying improvement and just how we should think about that impact from component pricing as we move through fiscal 2020.

Steven Fieler

Chief Financial Officer, HP, Inc.

A

It's fair to assume that some level of the profit margin rate in dollars did come from that, but it really is on the backs of how we executed our strategy and overall pricing discipline. There are a lot of puts and takes to pricing. Obviously commodities have been favorable for us. Overall currency has been a headwind for us. And so as you take that all into consideration, in addition to the competitive dynamics, it's hard to specifically quantify how much of that exceptional performance was due to the commodities.

As we think about FY 2020 and certainly even from Q4 to Q1, we'd expect commodity costs to be a bit more stable, and therefore I don't expect as much tailwind in Q1 and certainly as we enter into the second half as we saw this year. That being said, we continue to have a more structural opportunity to improve our mix. And again, the team deserves a lot of credit for remaining disciplined in the overall pricing strategy.

Operator: The next question is from Aaron Rakers with Wells Fargo. Please go ahead.

Aaron Rakers

Analyst, Wells Fargo Securities LLC

Q

Thanks. Just building on that last question, I have a follow-up as well. Thinking about setting component pricing to the side and thinking about the mix shift of the business, it does look like your ASP erosion on particularly your notebooks has accelerated here a little bit. I just wanted to understand how I would think about the mix shift dynamic underneath of that. Any metrics you can share of how successful you've been in terms of mix shifting within the PC portfolio and where you think the biggest incremental levers are to continue to see that mix shift going forward as component pricing starts to stabilize and potentially whether or not we should think about ASPs on a blended basis moving higher going forward in PCs?

Steven Fieler

Chief Financial Officer, HP, Inc.

A

So on a full-year basis, mix has definitely been a tailwind for us. In Q4 specifically, and as you point out in notebooks, we did see an ASP decline. That's driven by FX, so that's a certain part of it at a total PS level, that's about 2 points, and then rate was 2 points. When we look at the rate specifically, and I touched on this in my prior comments, but the overall industry-wide pricing adjustments in the market due to the commodity costs dynamics, in certain product categories like Notebooks, pricing is also dependent upon the supply availability that you get. And so all that together is really what drove the ASP down year-over-year in Q4.

In terms of upside potential, I'd say we view it as significant over time. And when we think about mix, the good news for HP is we're under-indexed in such favorable parts of the PC marketplace, if you think about displays and accessories, if you think about premium categories and gaming, which we grew double digits this past quarter, if you think about services. And so all of that, we view as more structural, long-term tailwind for us. But in the near-term, yeah, we're facing so many dynamics – Intel being another one as an example and the overall supply that we get. But when we think long term, a lot – a lot of potential upside on our mix as we can continue to drive these growth initiatives.

Aaron Rakers

Analyst, Wells Fargo Securities LLC

Q

Yeah. Okay that's just perfect. And then as a follow-up kind of that Intel comment. The CPU shortage situation's kind of persisted for much longer than what I think anybody would have expected. I'm just curious of how you guys have kind of thought about mitigating that impact in the portfolio. There are seemingly more competitive alternatives out there in the CPU market today. I'm just curious of how you see or what you think the explanation is for the CPU shortage and whether or not there's other ways to potentially bridge the impact of revenue here, what seemingly looks like it's going to persist, as you said, through the first half of 2020 at this point.

Enrique Lores

President, Chief Executive Officer & Director, HP, Inc.

A

Yes. You're right that we have been in this situation for about a year now. And as I said before, we expect it to continue for probably at least two other quarters. I think the question about the why is probably a better question to ask to Intel than to us. What I can tell you though is that we continue to be committed to use multiple CPU providers. We are working with other vendors. We have been growing the mix of other categories. But Intel is still a very large part of our portfolio and therefore there are shortages. We need to navigate through those and manage our business that way.

Steven Fieler

Chief Financial Officer, HP, Inc.

A

And just one other mitigation fraction, I'm kind of repeating my earlier comment, but it's important to reiterate. And that is, we do expect a better mix of units, which is should help mitigate the profit impact of this. While there may be revenue, less so on the bottom line.

Enrique Lores

President, Chief Executive Officer & Director, HP, Inc.

And I think we are running out of time now, so I want to thank everyone for joining us today and taking the time to be here. And I like to emphasize the confidence that we have in our strategy and the multiple levels that we have to create value. We are, we have been and we will be relentless in managing costs and reinvesting to create long-term value. And we know how to manage through the current dynamics, which is exactly what we have been doing during the last years. We will continue to execute our strategy with rigor, and we will keep our focus to drive long-term value creation for our shareholders. Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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