26-Nov-2024

HP, Inc. (HPQ)

Q4 2024 Earnings Call

CORPORATE PARTICIPANTS

Orit Keinan-Nahon
Senior Vice President-Finance & Head-Investor Relations, HP, Inc.

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

Karen L. Parkhill
Chief Financial Officer, HP, Inc.

OTHER PARTICIPANTS

Wamsi Mohan
Analyst, BofA Securities, Inc.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Irvin Liu
Analyst, Evercore ISI

A.M. Sacconaghi, Jr.
Analyst, AB Bernstein

Samik Chatterjee
Analyst, JPMorgan Securities LLC

Asiya Merchant
Analyst, Citigroup Global Markets Canada, Inc.

Krish Sankar
Analyst, TD Cowen

David Vogt
Analyst, UBS Securities LLC

Michael Ng
Analyst, Goldman Sachs & Co. LLC

Ananda Baruah
Analyst, Loop Capital Markets LLC

Aaron Rakers
Analyst, Wells Fargo Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to the Fourth Quarter 2024 HP, Inc. Earnings Conference Call. My name is Lisa, and I'll be your conference moderator for today's call. At this time, all participants will be in a listen-only mode. We will be facilitating a question-and-answer session towards the end of the conference. [Operator Instructions] As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the call over to Orit Keinan-Nahon, Head of Investor Relations. Please go ahead.

Orit Keinan-Nahon

Senior Vice President-Finance & Head-Investor Relations, HP, Inc.

Good afternoon, everyone, and welcome to HP's fourth quarter 2024 earnings conference call. With me today are Enrique Lores, HP's President and Chief Executive Officer; and Karen Parkhill, HP's Chief Financial Officer.

Before handing the call over to Enrique, let me remind you that this call is a webcast, and a replay would be available on our website shortly after the call for approximately one year. We posted the earnings release and accompanying slide presentation on our Investor Relations web page 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 these risks, uncertainties, and assumptions, please refer to HP's SEC reports, including our most recent Form 10-K. 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 estimates based on information available now and could differ materially from the amounts ultimately reported in HP's SEC filings.

During this webcast, unless otherwise specifically noted, all comparisons are year-over-year comparisons with the corresponding year-ago period. In addition, unless otherwise noted, references to HP channel inventory refer to Tier 1 channel inventory and market share references are based on calendar quarter information. 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 earning release for those reconciliations.

With that, I'd now like to turn the call over to Enrique.

Enrique Lores

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

Thank you, Orit, and thank you all for joining today's call. Today, we will cover our Q4 performance and 2024 full-year results. We will also discuss expectations for the year ahead and how we are sharpening our strategic focus to lead the future of work.

Let's start with our Q4 results. For the second consecutive quarter, revenue was up 2% year-over-year. Both Personal Systems and Print demonstrated steady progress. In Personal Systems, Commercial units and share gains were strong contributors to revenue growth.

In Print, we drove revenue growth for the first time since fiscal year 2021. Our growth businesses also performed well, significantly contributing to our growth in the quarter. Non-GAAP EPS grew 3% to $0.93, in line with outlook. We accelerated our Future Ready structural cost-saving plans while continuing to invest in our growth businesses. In short, we did what we said we would do.

Q4 also capped off an exceptional year of innovation. At our annual HP Imagine event in September, we showcased breakthrough experiences and platforms with new AI-powered capabilities. Our expanded AI PC portfolio is now equipped with HP AI companion, a bespoke application. The app uses generative AI to help analyze private files, create content or respond quickly to key tasks. Through partnerships with a growing number of software companies, we are bringing to life even more experiences for our customers.

For example, we are collaborating with Zoom to power AI companion with on-device capabilities that can streamline meeting preparation, quickly locate relevant documents, and automating key tasks based on in-meeting decisions. These types of experiences illustrate our powerful next-gen AI compute will be in the workforce.

We also launched HP Boost, a solution that allows data scientists and AI developers to share GPUs remotely, and we continue to enhance our workforce experience platform, adding the ability to monitor and manage printers, and integrating popular business applications from Microsoft and ServiceNow.

Our recent acquisition of Vyopta, a provider of collaboration management solutions, will strengthen the platform. It will offer customers comprehensive control over their digital ecosystems from a single dashboard.

In the AI PC category, we continue to lead with performance and security. We are delivering powerful experiences, industry-leading battery life, and flexible form factors. Building on our Consumer launches last quarter, we introduced the most powerful next-gen AI business notebook. The EliteBook X is ideal for tech experts and business consultants who run large applications for analysis. It is powered by an industry-leading 55 TOPS of NPU performance. At the same time, it offers AI-enhanced protection to secure the most sensitive data.

Freelancers and creators can also power their work with the OmniBook Ultra Flip, our first 2-in-1 AI PC. With it, they have the ability to design with AI, whether sketching, editing or collaborating. And with the power of HP Wolf Security, they can keep data secure and protected.

Beyond PC, we showed how we are making printing smarter with HP Print AI. It is the industry's first AI-powered intelligent print experience that simplifies and enhances printing. The perfect output feature uses AI to deliver the perfect print, solving universal frustrations like spreadsheet and tables printing over multiple pages. Our innovations this quarter underscore our commitment to delivering impactful customer-driven solutions to define the future of work.

Before I continue, I want to take a moment to acknowledge the incredible teams across HP delivering these experiences. Your commitment to innovate for our customers, partners and the planet is inspiring.

Let me now turn to business unit performance. For the third consecutive quarter, revenue in Personal Systems was up year-over-year with 2% growth driven by strength in Commercial. We saw continued pressure on commodity costs, which impacted operating profit, and we will continue to take actions on pricing and cost to mitigate this over time.

We drove gains in worldwide PC market share year-over-year, particularly in high-value category, including Commercial and Consumer premium. We believe there is more opportunity here, and we will continue to prioritize these categories.

AI PC units this quarter were more than 15% of our shipments. In fact, as recently published by Canalys, we have the number one market share of AI PCs in the Windows ecosystem, and we intend to maintain this position. Looking ahead, the power of AI, coupled with the strength of our portfolio, will enable us to deliver new levels of efficiency and security, critical to the future of work.

We expect AI PC penetration to continue to further strengthen our Commercial leadership. And since the Windows 11 refresh has ramped lower than previous industry transitions, we expect to see the impact of the upgrade to be more pronounced in 2025. In the growth areas, Hybrid Systems and PS services delivered strong performance, with revenue up year-over-year. And we grew Gaming revenue quarter-over-quarter in line with normal seasonality.

Turning to Print, revenue grew 1% year-over-year. The increase was fueled by strong performance in Supplies and Industrial Graphics, offset in part by a competitive pricing environment. In both home and office, we gained share year-over-year. In home, we continue to gain share across all categories, especially in Big Tank. And we delivered on our commitment to regain share in office.

In growth areas, Consumer Services and Industrial performed strongly, with revenue growth year-over-year. We believe sustainability is core to our long-term growth, and we continue to operate with a sense of purpose and intentionality. For example, in Q4, our HP Renew Solutions team received industry recognition for making it easier for customers to purchase high-performing refurbished hardware. We were also recognized on Newsweek's World's Most Trustworthy Companies list.

Let me now talk about the full-year performance. Revenue was flat year-over-year and non-GAAP EPS grew 3%. While the market recovery was slow, especially in the first half, we had a strong second-half recovery, with positive momentum going into the new fiscal year.

We are pleased with our key growth areas, which collectively grew faster than the rest of the portfolio and drove approximately 20% of our total company revenue for the year. We generated strong free cash flow, aligned with our annual guidance. We returned nearly 100% of our free cash flow to shareholders, in line with our long-term commitment.

Over the past year, we have continued to drive solid progress with our Future Ready strategy. We said we would invest in innovation, focusing our portfolio on growth and integrating new AI capability, and we have done that. We have successfully implemented new business models as we shifted more offerings to subscriptions and solutions, increasing value per customer.

We told you we were continuing to improve our operational capability. Here, we have taken steps to ensure a more resilient supply chain, improved our order-to-delivery time, and reduced customer call time using AI.

Overall, fiscal year 2024 was a year of steady progress. We know our plans are working, and we are well-positioned to capitalize on new opportunities that drive sustained growth.

We are looking ahead with a clear focus on leading the future of work. With the proliferation of AI and flexible work, customer expectations have continued to evolve. Employers want to drive growth, while employees are seeking professional fulfillment. At this intersection is an attractive opportunity for HP. With our powerful portfolio of solutions and the right team in place, we believe we have what it takes to lead the next era.

Here is how. First, we are investing and innovating aggressively in new AI-powered capabilities and software. We will focus on delivering a cutting-edge AI-powered tech stack. This is an exciting shift for our customers everywhere. It will provide them with new insights on automation, personalized experiences and foster team collaboration.

Our recently established technology and innovation organization, TIO, brings together all our software resources into a single team. The TIO will accelerate our move from a transactional hardware company to a more experience-led organization.

Second, we are leveraging the power of our portfolio to capture growth opportunities in Commercial and solutions. Commercial segments are growing faster than Consumer segments, and we are prioritizing accordingly.

In Personal Systems, for example, Commercial TAM is expected to grow three times faster than Consumer. And in Print, contractual office and industrial TAM are expected to perform better than Consumer and transactional office.

Thirdly, we are maintaining our focus on capturing profitable growth in premium consumer and gaming. For example, we are taking measures to increase growth in consumer services, building on the success of programs like our HP all-in subscription plans.

And in operations, we will continue to evolve our supply chain capabilities to support our future of work strategy, while ensuring supply chain resiliency and to aim process automation and continuous improvement in our cost structure.

Looking forward to fiscal year 2025, we assume that the PC market will grow faster than in fiscal year 2024, fueled by multiple catalysts for refresh, including AI. And we expect the Print market to decline low-single digits. We expect revenue for both Personal Systems and Print to perform at least in line with the respective market. We have significant opportunities to accelerate in our key growth areas, especially in Commercial, where the market is growing faster than Consumer.

We also remain committed to returning approximately 100% of free cash flow over time, unless opportunities with a higher return on investment arise and as long as our gross leverage ratio remains under 2 times EBITDA. We are confident our strategic focus and operational capabilities will enable us to deliver solid growth in fiscal year 2025 across revenue, non-GAAP earnings and EPS, and free cash flow.

I will pause here and turn it over to Karen.

Karen L. Parkhill

Chief Financial Officer, HP, Inc.

Thank you, Enrique, and good afternoon, everyone. We delivered solid financial results in Q4, with growth across both Personal Systems and Print, driving a year-over-year increase in revenue for the second quarter in row. We grew non-GAAP EPS year-over-year and delivered strong free cash flow in the quarter, solidly within our full year guidance range. And as committed, we returned nearly 100% of our free cash flow to shareholders for the full fiscal year.

Taking a closer look at the details of the quarter, net revenue was up 2% nominally and in constant currency. In fact, we grew in constant currency across all regions, with Americas and EMEA growing 2% and APJ growing 3%. Gross margin was 21.4%, flat year-over-year, as we offset rising commodity costs with pricing and cost actions.

Non-GAAP operating expenses reflect continued investment in key strategic initiatives, offset in part by cost reductions, including the acceleration of Future Ready cost savings. All in, non-GAAP operating profit was $1.2 billion, in line with our expectations.

Below the op profit line, non-GAAP net OI&E was down year-over-year, with lower currency-related losses and reduced levels of short-term financing activities. Finally, with a diluted share count of approximately 970 million shares, our non-GAAP diluted net earnings per share was $0.93, a year-over-year increase of $0.03.

Now, let's turn to segment performance. Personal Systems revenue was up 2% nominally and 3% in constant currency, with higher Commercial volumes and increased ASP, as we continue to adjust pricing where possible to mitigate increased component costs.

We outperformed the market in Commercial, with total units up 1% year-over-year, and we continue to see progress in key growth areas, particularly in hybrid systems that delivered strong growth for the second straight quarter.

Drilling more into the details, Commercial revenue was up 5% on 4% unit growth with improved pricing and favorable mix. We increased our market share with gains in high-value Commercial premiums. In fact, our gains in Commercial more than offset continued market softness in Consumer, where revenue was down 4%, with units down 3%, particularly in China and as expected.

Our PS operating margins were a little lower than expected, reflecting the headwinds from higher commodity costs and continued investment in strategic initiatives, not fully offset by repricing efforts and Future Ready savings.

In Print, our results reflected our focus on execution in a market that is showing signs of stabilization. Total Print revenue increased 1% on a reported basis and 2% in constant currency, driven by supplies in key growth areas. Momentum in Industrial Graphics continued, with growth in hardware, supplies and services. We also saw double-digit growth in Consumer Subscriptions revenue.

By customer segment, Consumer grew 3% year-over-year on 10% unit growth, with share gains across all categories. In Commercial, while revenue declined 1% in the competitive pricing environment, units increased 9%, with share gains across all markets except China, as we purposely focused on profitable long-term unit growth.

Print operating margin of 19.6% was not only up year-over-year but above the high end of our range, with favorable mix and savings from our accelerated Future Ready cost actions.

Looking holistically at our Future Ready cost plans, we are pleased with the progress we made in the quarter to accelerate our actions, and at this point, are ahead of the plans we initially laid out. In fact, with one year to go on our three-year plan, we have driven roughly 80% of our total program goal of $1.6 billion of annualized gross run rate savings.

As part of Future Ready, we have modernized our data infrastructure across the company, reduced platforms in Personal Systems by over one-third, allowing for reduced commodity complexity and driven further portfolio and resource reductions across core Print. We look forward to completing these plans to drive further effectiveness and efficiency across the company in the next year.

Now, let me move to cash flow and capital allocation. We generated more than $1.6 billion in cash from operations and $1.5 billion in free cash flow. And free cash flow for the fiscal year was $3.3 billion, solidly within the guidance range we set at the beginning of the year.

We continue to improve our cash conversion cycle this quarter, driving days payable up as a result of improving payment terms and higher manufacturing activity, and inventory days down with lower strategic buy activity.

Lastly, we returned approximately $1.2 billion to shareholders through both share repurchase and dividends, and finished the quarter within our target leverage range. For the year, we returned close to $3.2 billion to shareholders, nearly 100% of our free cash flow.

Our Q4 and FY 2024 results reflect the consistent progress we are making to drive profitable growth and maintain our leadership position in a steadily improving market. And we intend to continue this momentum into next year as we drive further growth and investment in strategic areas, including the future of work.

As we look ahead in FY 2025, let me start with our segments. In Personal Systems, as Enrique said, we are aligned with industry experts, projecting the PC market to increase mid-single digits in 2025, with the Commercial market growing faster than Consumer. We expect our fiscal year 2025 revenue to grow at least in line with the market and to be stronger in the second half of year, driven by normal seasonality, timing of the Windows 11 refresh and increased penetration of AI PCs. At this point, we anticipate AI PCs will make up approximately 20% of our PC unit shipments in FY 2025.

On operating margins, we expect to be in the upper half of our 5% to 7% range for the year, but to remain in the lower half in Q1, given continued pressure on our commodity costs. And while we have put in place cost reduction and pricing actions to offset these pressures, they will take time and will ramp through the year, leading to stronger margins expected in the second half.

In Print, we expect to perform at least in line with the overall market. And as Enrique said, we are aligned with industry experts projecting the overall market to decrease low-single digits in 2025. We expect the pricing environment to stabilize and our ASPs to benefit from our focus on driving profitable share gains in strategic categories. Particularly in office, we see the opportunity to capture share in the contractual segments, where we are under-indexed.

We expect Supplies revenue to decline low to mid-single digits in FY 2025 in constant currency, consistent with our long-term outlook. And we expect our operating margin to continue to be near the top of our 16% to 19% long-term range, including in Q1, as we continue to exercise disciplined cost management and execute on our Future Ready plans.

Beyond the segment, we expect Corporate/Other to be relatively flat year-over-year, at approximately $1 billion. Keep in mind that due to the timing of our stock compensation expense, we expect approximately one-third of our annual Corporate/Other expense in Q1.

With all of this, we expect FY 2025 non-GAAP diluted net earnings per share to be in the range of $3.45 to $3.75, and FY 2025 GAAP diluted net earnings per share to be in the range of $3.06 to $3.36. For Q1, we expect first quarter non-GAAP diluted net earnings per share to be in the range of $0.70 to $0.76, and first quarter GAAP diluted net earnings per share to be in the range of $0.57 to $0.63.

Overall, we expect EPS to be stronger in the second half, with sequential improvements in each quarter. On FY 2025 free cash flow, we expect to deliver between $3.2 billion to $3.6 billion, with growth in line with earnings. As typical, we expect the second half to be stronger than the first, consistent with our net earnings and recognizing that our first quarter is typically lower, given the timing of our prior year incentive comp payment.

On capital allocation, we remain committed to returning approximately 100% of our free cash flow to shareholders over time as long as our gross leverage ratio remains under 2 times and there aren't better return opportunities.

In closing, we are excited for our future and also pleased to announce today that we are raising our annual dividend by 5% to $1.16 per share. This is the ninth consecutive annual increase since our separation in 2015, and reflects the confidence we and our board have in our long-term outlook ahead.

With that, I would like to hand it back to the operator and open the call for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. And we will now begin the question-and-answer session. [Operator Instructions] Our first questioner today will be Wamsi Mohan, Bank of America.

Wamsi Mohan
Analyst, BofA Securities, Inc.

Q

Yes. Thank you so much. Typically, your first quarter EPS is about 25% of the full year. This year, you're guiding to EPS that's closer to 20%. Can you talk about some of the puts and takes over there? I know you called out the timing of stock comp, but is there anything else that's driving the delta over there as well? And I have a follow-up.

Karen L. Parkhill
Chief Financial Officer, HP, Inc.

A

Yeah. Thanks for the question, Wamsi. In our Q1, EPS is typically down sequentially. So keep in mind, we have seasonal volume declines in the first quarter. And yes, we do have a sequential increase in Corporate/Other expense in the quarter, and that's really driven by the timing of our stock compensation expense. I said we expect roughly a third of it to hit in Q1.

Wamsi Mohan
Analyst, BofA Securities, Inc.

Q

Okay. Thanks, Karen. I guess my follow-up is really around your Future Ready transformation plan, where you've done a lot of cost optimization already. But when we look at the EPS guide for next year, presumably, most of that's really coming from share buybacks, which would mean that your organic operating income is roughly flat despite all these cost optimizations. Why should we not see a higher improvement in free cash flow next year, especially as you're starting to expect PCs to grow and you're also lapping some of these restructuring, or the magnitude, at least, is going down on restructuring charges as well? So, why isn't free cash flow somewhat materially higher range closer to a couple years ago? Thank you so much.

Karen L. Parkhill
Chief Financial Officer, HP, Inc.

A

Yeah. Thanks for the question. We're pleased with the free cash flow we delivered this fiscal year, and we do expect it to continue to grow roughly in line with earnings. We intend to drive continued improvement in working capital and free cash flow, just as we have in the past few years. We expect that to continue. And as we enter the third year of our Future Ready cost plan, we expect to spend a little less on restructuring charges. But we will offset with some slightly higher capital expenditures to support our growth plans. But again, we expect free cash flow to grow roughly in line with earnings.

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

A

And also, another comment about your first observation, when we look at EPS growth year-on-year, it is driven both by share buybacks, but we are also expecting growth of operating profit, and this is really what is supporting the midpoint of the guide.

Wamsi Mohan
Analyst, BofA Securities, Inc.

Q

Okay. Thank you so much.

Operator: The next question is from Erik Woodring, Morgan Stanley.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Q

Awesome. Thanks for taking my question, guys. Enrique or Karen, I guess maybe, Karen, this one would be for you, is you've done 19% Print operating margins effectively three years in a row now, all in years in which Print revenue has been down low to mid-single digits. So maybe my question is, why is 16% to 19% the correct range, and why wouldn't it be higher, or has there been a degree of overearning that, at some point, should normalize in the future? I'm just trying to understand the relative outperformance versus the target. And then, I have a follow-up. Thanks.

Karen L. Parkhill
Chief Financial Officer, HP, Inc.

A

Yeah. Thanks for the question. You've seen us operate at this high end of the range, both in Q4 and the full year, and we do expect that to continue in FY 2025. We are focused on protecting our profitability in Print. We've been reducing unprofitable units through our shift to Big Tank. We've also been increasing the lifetime customer profitability with growth in our Subscription business, and we're gaining share in some of the higher-value categories in office.

As we think about the guide, the range going forward, we're maintaining the lower end of the range just so we can have flexibility to lean in where we find opportunity. But we're also going to remain cognizant of the dynamic market conditions that we've seen in recent years.

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

A

And Erik, this is very consistent with previous conversations. As Karen just said, we want to have flexibility to lean in in case we see opportunity to place more positive hardware units. And if we do see the opportunity, we want to have that, and this may put some pressure on the margin in a specific quarter. But nothing has changed from previous conversations.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Q

Right. Okay. No, very fair. Thank you, guys. And then my follow-up, Enrique, after a strong 4Q in which you gained share in both Print and PCs, can you maybe just help us understand maybe why you don't expect to gain share next year, talking about growing in line with the market? Is there any kind of competitive pressures that are arising maybe from, for example, where the yen is today, or are you just trying to be a bit more conservative in setting expectations so early in the year? And that's it for me. Thanks so much.

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

A

I would say it's more the latter, Erik. We want to be conservative in assumptions. Of course, our goal is going to be to grow share, but as we always say, grow share in profitable categories. Our goal is not to grow share for the sake of growing share. It's really about focusing on those areas where we see opportunity to do it in a profitable way. This year, we have grown share in PCs, especially in Commercial. And as we have said during the prepared remarks, Commercial is going to continue to be our priority.

Operator: Next, we'll take a question...

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Q

Thanks so much, guys.

Operator: Thank you, sir. And next, we'll take a question from Amit Daryanani, Evercore ISI.

Irvin Liu
Analyst, Evercore ISI

Q

Hi. Thank you. This is Irvin Liu on for Amit. I have one and a follow-up as well. So if I heard correctly, AI PC units were 15% of shipments during your fiscal Q4 and expect it to expand to 25% next year. As this mix expands, what sort of implications will this have for – will AI PCs have for ASPs and your PS margins?

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

A

We – thank you. We have not changed our view on the impact that AI PCs is going to – are going to have and current results support the assumptions that we have seen. AI PCs are going to drive an improvement of average selling price. What we have been saying until now and we confirm is the year from now, we expect them to be between 40% and 60% of the mix and half around between a 5% and a 10% impact on the overall category. That's the direction that we are taking, and the current shipments and pricing supports what we have seen until now.

Irvin Liu
Analyst, Evercore ISI

Q

Got it. Thank you. And then for my follow-up, with the upcoming change in administration and potential for tariffs, can you just talk about how you are positioned to mitigate any potential impacts to your supply chain?

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

A

Yeah. Perfect. Thank you. First, let me say that we are really willing to collaborate with the new administration to reach the best solution for both our customers and our shareholders.

If you think about what we've been talking about in the last few years, we have done a lot of work to make our supply chain footprint more resilient. And we have been building factories in different parts of the world to be able to respond to changes in the geopolitical environment. So today, we're in a much stronger position than we were three years ago. And we think that compared to other companies in our industry, we are in a strong position.

At this point, it's hard to know what exactly the new tariffs are going to be. What I can say is we have a strong team that knows how to manage this type of environment. And as we know, what the final policy will be, we will build the best plan for the company.

Operator: Our next question today will come from Toni Sacconaghi, Bernstein.

A.M. Sacconaghi, Jr.
Analyst, AB Bernstein

Q

Yes. Thank you. I just wanted to follow-up on the last question first. My understanding is outside of Inkjet printer cartridges, essentially, everything HP makes is outside of the country and imported. So if we did have a tariff on all incoming goods, which is sort of the current statement from the administration, how does HP respond to that? I understand you may have less China exposure, but you're still making essentially all of your products aside from Inkjet cartridges, I believe, outside the US. So, how would you address a global tariff on imported goods specifically?

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

A

Yeah. We have said, Toni, at this point, is we don't want to speculate on what the final tariffs are going to be. We will respond to whatever the final decisions are and actively manage our supply chain to do that. You're correct, we have a small percentage of production today in the US. It's a bit broader than the Inkjet cartridges, but as you said, we produce most of our products like cartridges.

A.M. Sacconaghi, Jr.
Analyst, AB Bernstein

Q

Okay. And if I could follow-up, maybe you could just clarify what's your Mexico exposure, because there actually has been a policy statement on that? So, what is your Mexico exposure?

And then as my follow-up, Enrique or Karen, as we look forward to next year, it sounds like you're expecting Supplies to decline 3%, 4% low-single digits, but potentially, the Printing business to grow, which would mean that hardware would be positive. Why would that mix shift not pressure margins? And what's the offset to keep margins at the high end of the range? Thank you.

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

A

Let me take both questions, Toni. First all, on Mexico, we don't disclose the specific percentage of products that we get from them. So, I will defer the answer to that question.

In terms of Print, what we have said is in fiscal year 2025, we expect the market to decline and this should be consistent to what you see also from the HP perspective. Our goal is to do at least as well as market, but we are going to see some pressure on revenue from the Print perspective. And as you said, our guide, our expectation is that Supplies, consistently with what we have been saying in the past, will continue to decline low to mid-single digits or no change in our view on that.

Operator: Your next question will come from Samik Chatterjee, JPMorgan.

Samik Chatterjee
Analyst, JPMorgan Securities LLC

Q

Hi. Thanks for taking my question. I guess for the first one, if I can go to the outlook that you shared for the PC market, I think you said Commercial in particular growing higher than mid-single digit. I know that's sort of the consensus right now in the industry analysts, but just curious how you sort of thinking about that outcome sort of playing out in terms of the confidence in enterprises like sort of refreshing ahead of that deadline in terms of Windows end of life, but particularly given that we've all been a bit surprised that enterprises haven't refreshed as much this year. How are you thinking about sort of the validity of that growth expectation, as well as the likelihood that they don't really deprioritize – when they're investing towards AI infrastructure, they don't end up deprioritizing PCs as a part of that spending sort of overall bucket that they're looking at? And I have a follow-up as well. Thank you.

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

A

Yeah. So I think, first of all, if we look at what has happened in Q4, we have seen revenue growth in the Commercial space of 5% and unit growth of 4%. So, we are already at a fairly significant growth in the Commercial PC space. And when we think about next year, first of all, we think that the fact that the Windows refresh has started in a slower way than previous transitions, as we shared last quarter, just makes the opportunity in 2025 bigger because there is a deadline in the fall next year where support costs for Windows 10 is going to significantly increase, and therefore, company will have a strong incentive to change.

On top of that, we continue to have an aged installed base that needs to be refreshed, which has been driving the growth that we have seen in Q4. And we – the mix of AI PCs will continue to grow, which also is going to create a tailwind for the business. But these are the key assumptions that we have. And on top of that, as we have done this year, we will continue to prioritize premium categories where we have been growing share, and this continues to be the goal for us as a company.

Samik Chatterjee
Analyst, JPMorgan Securities LLC

Q

Got it. Great. And for my follow-up, I mean, Karen, maybe this is for you, just going back to Wamsi's earlier question on this, what's driving the seasonality for earnings in 1Q? I understand the sort of drivers that are impacting earnings, but are you expecting anything different from a typical seasonality when it comes to the revenue outcomes for the quarter as well? If you can just clarify that.

Karen L. Parkhill
Chief Financial Officer, HP, Inc.

A

Yeah. So for revenue, we're expecting growth both year-over-year in the quarter and for the full year at the total company level, with strength in PS offsetting a likely decline in Print.

In terms of just our ramp through the year on EPS, we said that we expect a stronger second half and that Q1 should be our lowest quarter with improvement throughout the year. And I would say the main drivers of that are more pronounced PS revenue seasonality tied to the PC recovery, along with the actions that we're taking to improve PS margins in the back half. And as we already mentioned, we expect that step down in Corporate/Other costs as we move past Q1.

And I would say lastly, we're also expecting this higher penetration of AI PC models as we move through the year. So those, along with our growth segments, really drive an improvement to our margin profile.

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

A

And let me add a comment on cost. As we shared in the prepared remarks, we have seen pressure from commodity costs in Q4. We expect that this pressure will continue in Q1. But through the year, through repricing and through additional cost that we are – actions that we are taking to qualify lower cost components to concentrate volumes in a few specific SKUs, we will be able to compensate for that. And this also creates an improvement quarter-on-quarter that is what is supporting the guide.

Operator: Your next question will come from Asiya Merchant, Citi.

Asiya Merchant
Analyst, Citigroup Global Markets Canada, Inc.

Q

Hey. Thank you for taking my question. If I can just double click on your growth services. I think it was 20%, and I believe you said it grew mid-single-digits. How should we think about the expectations for these growth businesses to perform into next year? What are some of the drivers that would potentially accelerate growth here? Because I think at the analyst event, you guys did share higher growth expectations. And if you could talk about some of the drivers for that growth for the high – for the growth business? Thank you.

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

A

Yes. Thank you. So, it is probably worth that we talk about a few of them, so to explain and what are the expectations that we have for next year. But the overall is that they will continue to grow faster than the overall company, which is why for us are very important going forward.

If we think, for example, about growth that we expect in Consumer Services, we expect the number of subscribers to continue to grow. And also, we are expanding the portfolio of services that we offer.

During this year, we offered the paper-as-a-service program, we offered the All-in program, and we will see the adoption of these two programs to continue to increase. We also have seen solid growth, especially in the second half, on our Workforce Solutions portfolio, especially in the Print-as-a-Service, Device-as-a-Service, and Conference-Room-as-a-Service and we expect these businesses to continue their growth next year.

We have a strong second half on Hybrid Systems, but as the market – as the Commercial market recovers, we see growth in that category and we expect it to continue to grow in 2025. Across most of them, we see opportunities to grow driven by the market and also driven by the innovation that we are going to continue to bring to market across many categories.

This is why, for us, going forward, we see this strong opportunity in Commercial in redefining the future of work, which is basically integrating AI into our full portfolio and allowing customers from an enterprise perspective to drive productivity, and from an employee perspective, to increase the fulfillment that they get with the activities they do. And this is going to be more and more the overall focus of the company.

Asiya Merchant
Analyst, Citigroup Global Markets Canada, Inc.

Q

Thank you.

Operator: We'll take the next question from Krish Sankar, TD Cowen.

Krish Sankar
Analyst, TD Cowen

Q

Yeah, hi. Thanks for taking my question. I have two of them. First one, Enrique, thanks for your color on next year and AI PCs and all the good stuff. I'm kind of curious, what exactly is the definition of AI PC? Does it have a higher silicon content like NPU, CPU Memory? How do you describe AI PC, because it was 15% of last quarter mix? And if there is a higher silicon content, what is the BOM cost impact to margins? And then I had a follow-up.

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

A

Sure. So, when we talk about the 15%, we use the official definition that IDC is using, which are PCs that have an NPU built-in, and this is what we are using for 15% to be consistent with the rest of the industry.

Our focus really is more in what we call next-generation AI PCs that are defined by, first, having a stronger, more powerful NPU of about 40 TOPS; second, of being able to run what we call our AI companion, which is our own model designed to accelerate productivity in the office when running at the edge; and third, especially in the Commercial space, PCs that have enhanced security capabilities because of having the NPU and some of the software and models that we are building into them.

This next-gen AI PCs, we just started to ship during Q4. So, the impact they have had this year is limited, but what has made them very exciting is we have been able to give them to software companies to start developing new solutions. We displayed some of them in our Imagine event, and the impact in productivity that they are going to have is very significant.

But if you ask me how confident I am about the impact the AI PCs are going to have, is even more than before, because I have seen them in action. I see the opportunity that they bring, and I think it's going to be a very, very strong part of our portfolio in the coming years.

Krish Sankar
Analyst, TD Cowen

Q

Got it. Very helpful. Thanks for that, Enrique, for the clarification, too. And one other quick follow-up. You mentioned that commodity cost pressure is going to be there into the early part of next year. Typically, what is the lag effect you see? Because the reason I'm asking is that if you look at most forecasts, memory, DRAM and

NAND, which is a big part of your commodity cost, is expected to decline in calendar Q1. If that is true, when would you see the benefit of that? Thank you.

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

A

Yes. We expect to continue to see pressure from commodity costs through the first half of our fiscal year, so our calendar Q4 and calendar Q1. And then this to be mitigated in the second half of the year, especially because of all the work that we are doing first on repricing. We did repricing in Q4, we will continue to do that, but there is always a difference in time between cost increases and price increases. But over time, this gets compensated.

And also, as I mentioned before, the work that we are doing from a cost perspective, to qualify lower-cost components, to integrate or to increase the volume on some specific SKUs, simplifying our offering so we can buy more of a single component. The three actions should help us to mitigate the impact in the second half of our fiscal year.

Karen L. Parkhill
Chief Financial Officer, HP, Inc.

A

And I would just add, Krish, that our strategic buys helped us when commodity cost pressures first started. And now we're working on repricing and cost-down actions. It just takes time to take hold.

Operator: Up next is David Vogt, UBS.

David Vogt
Analyst, UBS Securities LLC

Q

Great. Thanks, guys, for taking my questions. The first one is maybe, Enrique, on Print. I just want to go back to the competitive landscape because the yen has been such a headwind for so long. It doesn't sound like you were that concerned or that impacted this quarter. Kind of what's going on in that market and how does that play out into fiscal 2025?

And then I'll give you my second question at the same time. So, given sort of the improvement that you're thinking about in the top line next year and the really strong margins in Print, given the Future Ready plan, any thought to why the capital return policy still fixates around sort of gross leverage at 2 turns, given the structural margin improvement that you've made in the Print business despite the revenue decline? And I'll just turn it back. Thank you.

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

A

Sure. I'll take the first one, and then Karen will take the second. So, in terms of competitive environment in Print, we have not seen a significant change. We continue to see our Japanese competitors taking strong advantage of the weakness of the yen and the pressure has not changed. What has changed is that during the last two quarters, as we announced at the beginning of the year, we have been working to aggressively reduce the cost of our products so we could compete more aggressively, and we have started to gain share, both in home and in office. But it's not so much a result of the competitive environment getting easier, it's really a consequence of all the work that we are doing as part of our Future Ready plan, as you said.

Karen L. Parkhill
Chief Financial Officer, HP, Inc.

A

And just on the capital allocation policy, returning capital to shareholders is a priority for us. And our capital allocation policy has not changed, where we still expect to return approximately 100% of our free cash flow over the long-term, as long as higher ROI opportunities aren't there, and we maintain our leverage ratio of 2 times, just under 2 times.

On the leverage ratio, we do evaluate it every year, and our analysis continues to indicate that this is the optimal level for us. And it's aligned with the credit rating that is also aligned with our peers and provides us ample access to short-term liquidity.

David Vogt
Analyst, UBS Securities LLC

Q

Got it. Thanks for the clarity, guys. Thank you.

Operator: The next question is Michael Ng, Goldman Sachs.

Michael Ng
Analyst, Goldman Sachs & Co. LLC

Q

Hey, good afternoon. Thank you for the question. I just have two as well. Just a follow-up on David's question regarding Print. It was great to hear that you're working to reduce the cost and price of your products, you see it in the unit growth this quarter. I was wondering if you expect to see continued unit growth as we head into next year as a result of some of your price actions.

And then I'll give you the second one as well. Just on the PC refresh, it's widely understood that this October 2025 is a hard deadline. I was just wondering, in prior cycles, have you seen enterprises do much by way of extended support? Or does that not really kind of impacting us at all? Thank you.

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

A

Yeah. In terms of Print, our expectation is that, next year, market is going to slightly decline. And this is our expectation and also the expectations from most of the industry analysts. Our goal is going to continue to grow share if units are profitable at the system level. So, this is continues to be our goal. But at this point, it's hard to predict exactly how competitors are going to be responding. Of course, we are going to maintain our effort to continue to reduce cost, as we always do.

And then in terms of the PC refresh, what we have seen previously is the companies respond to the deadline. And this is why we are saying that we expect this to accelerate through 2025, given that compared to previous refreshes, the refresh is going a little bit slower. And this is why in 2025 and especially in the second half, we expect an improvement or a further improvement of Commercial demand driven by this transition.

Operator: Next up, we'll take a question from Ananda Baruah, Loop Capital Markets.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Yeah, guys. Thanks for taking the question. Appreciate it. I guess, Enrique, sticking with Print and the market decline, can you give us your sense of what you're thinking for Commercial relative to Consumer? I guess I'll ask both here. Commercial decline, also the Consumer decline. And on the Commercial side, what are the trends, what are the sort of dynamics that are informing the market as you can best see them? How much is macro, how much is back to office, anecdotally? And then sort of how much is, call it, maybe shift to digital and other things? Thanks.

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

A

Okay. Let me provide some color on Print, Ananda. So, when we look at the different segments in Print, we expect that in 2025, Consumer will continue to decline. So, no change from what we have seen. In the office side, we see two dynamics. We see transactional that we expect that will decline. But we see what we call contractual office, where Managed Print Services is part of it, that will have a better performance than transactional.

And when we think about areas to focus for us, clearly, this is an opportunity because the market will perform better and also because our share is lower than in other segments, so you should expect us to really go after that category. And then finally, we expect to continue to see growth in the industrial space. We saw strong growth in the second half of this year, and we expect to continue to see that in 2025.

Ananda Baruah
Analyst, Loop Capital Markets LLC

Q

Got it. Thanks so much. Appreciate it.

Operator: Next up is Aaron Rakers, Wells Fargo.

Aaron Rakers
Analyst, Wells Fargo Securities LLC

Q

Yeah. Thanks for taking the questions. I'm going to throw two of them out right away. So, I guess as we kind of start to focus or definitely shift our focus to the Windows upgrade cycle looking into next year. I'm curious, as you guys think about the market opportunity, any of the data that you look at just sizing how large this AI or this Windows installed base, aged installed base looks to be as we think about that going forward?

And then I just want to be clear, like if you look at the PC market, my second question, if you look at your PC growth estimate of mid-single-digits, I think that more or less is in line with where industry shipment expectations are. Why would we not see some ASP benefit from these AI PCs on top of that unit growth as we look into next year? I'm just curious of how you're thinking about that. Thank you.

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

A

Sure. The first part of your question is the answer is definitely yes. We have a lot analytics that support the opportunity about the refresh analytics that we have and also analytics that Microsoft has and that we share because we – it's a common interest for both companies to drive. And this is what helps us to assess how much conversion has happened and how much opportunity we have going forward.

In terms of ASP help from the PC side, we have seen, so for this year, we have seen revenue growth above unit growth, and we expect a similar phenomena to happen in 2025 and this is part of the guide that we have provided today.

Karen L. Parkhill
Chief Financial Officer, HP, Inc.

A

Yes, we do expect that we will benefit from ASP growth next year and in the first quarter, and that's really just given the enhancement of premium offerings, including the richer mix of AI PCs.

***Operator**: And, everyone, at this time, there are no further questions.*

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

Look, perfect. Thank you, everybody, for joining today's call. I know it's a bit later than other calls, especially for those of you in the East Coast. So, thank you for being here. As you have heard, we are very optimistic about the plan that we have in 2025.

The company – our expectation is that the company will be growing both revenue and operating profit. And going forward, we see a strong opportunity in defining the future of work, in helping companies to drive productivity improvement and helping employees to get more fulfillment from their work, a very exciting opportunity that is going to be driving the priorities that we use going forward.

So, again, thank you for joining today. And for those of you in the US, we wish you a very happy Thanksgiving holiday. Thank you.

Operator: Once again, everyone, that does conclude today's conference. We would like to thank you all for your participation. You may now disconnect.