



HP Inc. (HPQ)

Updated February 28th, 2019 by Eli Inkrot

Key Metrics

Current Price:	\$20	5 Year CAGR Estimate:	11.5%	Volatility Percentile:	57.4%
Fair Value Price:	\$23	5 Year Growth Estimate:	5.8%	Momentum Percentile:	18.6%
% Fair Value:	89%	5 Year Valuation Multiple Estimate:	2.5%	Growth Percentile:	50.6%
Dividend Yield:	3.2%	5 Year Price Target	\$30	Valuation Percentile:	76.1%
Dividend Risk Score:	B	Retirement Suitability Score:	B	Total Return Percentile:	73.7%

Overview & Current Events

Hewlett-Packard's story goes back to 1935 with two guys in a one-car garage making a huge impact on electronic test equipment, computing, data storage, networking, software and services for almost eight decades. On November 1st, 2015 Hewlett-Packard spun off Hewlett Packard Enterprise Company (HPE) – which was its enterprise technology infrastructure, software and services business – and changed its name to HP Inc. (HPQ). Today HP Inc. creates technology mainly in two segments: its portfolio of printers and through personal systems (computers and mobile devices). The \$31 billion company generated \$59 billion in annual revenue last year.

On February 27th, 2018 HP Inc. released Q1 fiscal 2019 results for the period ending January 31st, 2019 (the company's fiscal year ends October 31st). For the quarter the company reported revenue of \$14.7 billion, up 1% (2% in constant currency) from Q1 fiscal year 2018. Non-GAAP earnings-per-share equaled \$0.52 per share, within the company's previous guidance of \$0.50 to \$0.53. Personal Systems brought in \$9.7 billion in revenue and \$410 million in earnings before taxes. Printing generated a little over half of the amount of revenue, \$5.1 billion, but a much greater amount of earnings before taxes totaling \$821 million.

HP Inc. provided an updated outlook for Q2 and full year fiscal 2019. The company anticipates non-GAAP diluted earnings-per-share to be in the \$0.50 to \$0.53 range for Q2 2019 and full year results to come in between \$2.12 and \$2.22, reaffirming the company's previous guidance. Shares opened 16% lower on the collective news.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	---	---	---	---	---	---	---	\$1.53	\$1.48	\$2.02	\$2.15	\$2.85
DPS	---	---	---	---	---	---	---	\$0.37	\$0.52	\$0.55	\$0.64	\$0.85
Shares	---	---	---	---	---	---	---	1,712	1,650	1,560	1,500	1,400

For this year management anticipates earnings-per-share will grow between 5% and 10%. We believe this sort of growth is achievable, but have tended towards the lower end of that range over the intermediate-term as a starting assumption. While HP is a leader in its printing and personal computing markets, these are areas that face challenges as consumers continue to shift to mobile devices. Moreover, traditional printing faces digital risk and environmental concerns. The adoption of 3D printing could help; HP is already entrenched in that industry and thus stands a good shot at capturing new growth, but this is yet to be seen.

We do not anticipate that the dividend will greatly outpace earnings-per-share growth over the long haul. So far the company has been retiring a substantial portion of shares, which is aided by the below average valuation. Keep in mind that this allows per share results to advance at a greater clip than business results.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	---	---	---	---	---	---	---	8.3	12.0	11.3	9.3	10.5
Avg. Yld.	---	---	---	---	---	---	---	3.9%	3.0%	2.4%	3.2%	2.8%

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The combined entity known as Hewlett-Packard used to trade hands at a low to mid-teens earnings multiple. Since the split something closer to 10 or 11 times earnings has been more typical for HP Inc., as investors are still waiting to see whether or not the legacy business can continue to evolve. We believe this is a reasonable starting place, given the combination of an unknown growth trajectory coupled with a solid operating business. This would imply the possibility for a reasonable improvement in valuation, with business growth and the dividend playing larger roles in shareholder returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	---	---	---	---	---	24%	35%	27%	30%	30%

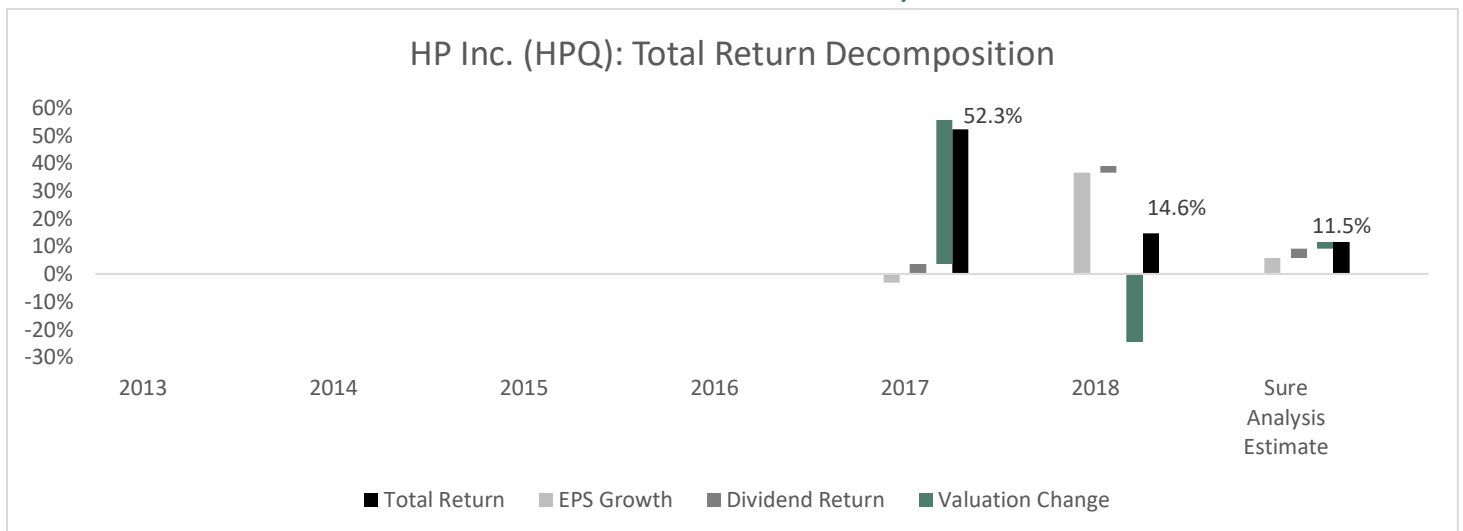
HP Inc. does enjoy competitive advantages as a leader in its two legacy businesses. Granted the long-term viability of these markets are unknown, but for now HP Inc. has a \$3+ billion annual underlying profit machine. Should consolidation come along, HP Inc. stands to benefit. Moreover, the dividend payout ratio – taking up less than a third of earnings – allows for a good amount of flexibility. We believe it is prudent to keep the dividend payout ratio relatively low, allowing ample room for share repurchases and M&A activity down the line. Things can change quickly in technology, so it can be helpful to have the resources available to “buy” your way into the next latest trend.

As of the most recent report HP Inc. held \$3.4 billion in cash, \$18.9 billion in current assets and \$32.5 billion in total assets against \$24.2 billion in current liabilities and \$32.5 in total liabilities. Long-term debt is easily manageable – sitting at \$4.7 billion or less than 1.5 times yearly profits. Meanwhile, accounts payable has traditionally been substantial – potentially demonstrating the company’s financial clout - and currently sits at \$14.6 billion (45% of current liabilities).

Final Thoughts & Recommendation

Shares are down slightly since our last review. HP’s legacy business may ultimately decline, but for the moment the company’s profit generation is impressive. Moreover, there are avenues for innovation in the future. When you pair this with a security trading under 10 times earnings, and a 3%+ dividend yield, HP earns a buy ranking. HP Inc.’s future will largely depend on how long of a runway the company’s legacy businesses have (is it two years or two decades, for example) and how well the company can adapt to new technologies in the future.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue (\$B)	114.55	126.03	127.25	120.36	112.30	56.65	51.46	48.24	52.06	58.47
Gross Profit	27028	30181	29827	27972	25918	11220	9939	8998	9578	10669
Gross Margin	23.6%	23.9%	23.4%	23.2%	23.1%	19.8%	19.3%	18.7%	18.4%	18.2%
SG&A Exp.	11613	12822	13577	13500	0	0	57	4012	4381	4866
D&A Exp.	4780	4820	4984	5095	4611	4334	4061	332	354	528
Operating Profit	11018	12916	11389	9289	21410	9793	8703	3761	4006	4319
Op. Margin	9.6%	10.2%	9.0%	7.7%	19.1%	17.3%	16.9%	7.8%	7.7%	7.4%
Net Profit	7660	8761	7074	N/A	5113	5013	4554	2496	2526	5327
Net Margin	6.7%	7.0%	5.6%	-10.5%	4.6%	8.8%	8.8%	5.2%	4.9%	9.1%
Free Cash Flow	9684	7789	8100	6865	8409	8480	3423	2819	3275	3982
Income Tax	1755	2213	1908	717	1397	939	-186	1095	750	-2314

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets (\$B)	114.80	124.50	129.52	108.77	105.68	103.21	106.88	28.99	32.91	34.62
Cash & Equivalents	13279	10929	8043	11301	12163	15133	7584	6288	6997	5166
Acc. Receivable	16537	18481	21386	19659	19020	16778	4825	4114	4414	5113
Inventories	6128	6466	7490	6317	6046	6415	4288	4484	5786	6062
Goodwill & Int.	39709	46331	55449	35584	34293	33267	5680	5622	5625	6421
Total Liabilities	74035	83722	90513	85935	78020	76079	78731	32876	36321	35261
Accounts Payable	14809	14365	14750	13350	14019	15903	10194	11103	13279	14816
Long-Term Debt	15830	22304	30634	28436	22587	19525	8871	6813	7819	5987
Total Equity	40517	40449	38625	22436	27269	26731	27768	-3889	-3408	-639
D/E Ratio	0.39	0.55	0.79	1.27	0.83	0.73	0.32	-1.75	-2.29	-9.37

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	6.7%	7.3%	5.6%	-10.6%	4.8%	4.8%	4.3%	3.7%	8.2%	15.8%
Return on Equity	19.3%	21.6%	17.9%	-41.4%	20.6%	18.6%	16.7%	20.9%	-69.2%	-263%
ROIC	13.5%	14.6%	10.7%	-20.9%	10.1%	10.3%	10.9%	12.5%	68.9%	109%
Shares Out.	NA	NA	NA	NA	NA	NA	NA	1,712	1,650	1,560
Revenue/Share	47.01	53.13	59.80	60.97	57.59	29.63	28.03	27.68	30.59	35.78
FCF/Share	3.97	3.28	3.81	3.48	4.31	4.44	1.86	1.62	1.92	2.44

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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