



HP Inc. (HPQ)

Updated September 26th, 2019 by Jonathan Weber

Key Metrics

Current Price:	\$18	5 Year CAGR Estimate:	11.1%	Volatility Percentile:	62.4%
Fair Value Price:	\$21	5 Year Growth Estimate:	5.0%	Momentum Percentile:	13.0%
% Fair Value:	86%	5 Year Valuation Multiple Estimate:	3.0%	Growth Percentile:	38.7%
Dividend Yield:	3.5%	5 Year Price Target	\$27	Valuation Percentile:	77.6%
Dividend Risk Score:	C	Retirement Suitability Score:	B	Total Return Percentile:	70.8%

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 that has lasted for more than 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 company is valued at \$27 billion.

HP reported its third quarter (fiscal 2019) results on August 22. The company reported revenue of \$14.6 billion for the quarter, which was slightly more than what the analyst community had forecasted, and up marginally from the previous year's quarter. Currency rates were a headwind, organic revenues (adjusted for forex movements) were up 2% year over year, which is a decent growth rate for the company.

Non-GAAP earnings-per-share totaled \$0.58 per share during the quarter, which easily beat the analyst consensus estimate. Earnings-per-share were up by a solid 12% versus the prior year's quarter. HP Inc. provided an updated outlook for Q4 during the Q3 earnings release. The company anticipates non-GAAP diluted earnings-per-share of \$0.55 to \$0.59 for Q4 2019, which would result in earnings-per-share of \$2.20, for the current year, using management's midpoint of the fourth quarter guidance range. This would equate to a year-over-year earnings-per-share growth rate of close to 10% versus fiscal 2018, which would be a solid result for the company. During the third quarter HP continued to reward shareholders handsomely, paying out \$800 million via dividends and share repurchases.

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	\$2.20	\$2.81
DPS	---	---	---	---	---	---	---	\$0.37	\$0.52	\$0.55	\$0.64	\$0.86
Shares¹	---	---	---	---	---	---	---	1,712	1,650	1,570	1,500	1,300

HP Inc. does not have a long history as a standalone company, as it was created just a few years ago. HP grew its earnings-per-share meaningfully between 2016 and 2018, while also ramping up its dividend payments.

During the last couple of years HP's earnings-per-share rose thanks to a combination of growing net earnings and a declining share count, although the huge growth rate from 2018 likely will not be replicated in the future. For this year, management anticipates that earnings-per-share will grow by close to 10%. We believe this sort of growth is achievable during the current year, but we believe that the long-term growth rate will be closer to 5%.

HP is a leader in the printing and personal computing markets, but these are areas that face challenges as consumers continue to shift to mobile devices. The adoption of 3D printing could help, as HP is already entrenched in this industry, but so far the majority of profits are generated by traditional printers and printing products. Through a low revenue growth rate, and a solid pace of share repurchases, HP has a good chance of growing meaningfully going forward.

¹ In Millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	---	---	---	---	---	---	---	8.3	12.0	11.3	8.2	9.5
Avg. Yld.	---	---	---	---	---	---	---	3.9%	3.0%	2.4%	3.5%	3.2%

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 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 multiple, given the combination of an unknown growth trajectory coupled with a solid operating business. Shares therefore look somewhat undervalued at the current price, which should result in some total return tailwinds going forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	---	---	---	---	---	24.2%	35.1%	27.2%	29.1%	30.5%

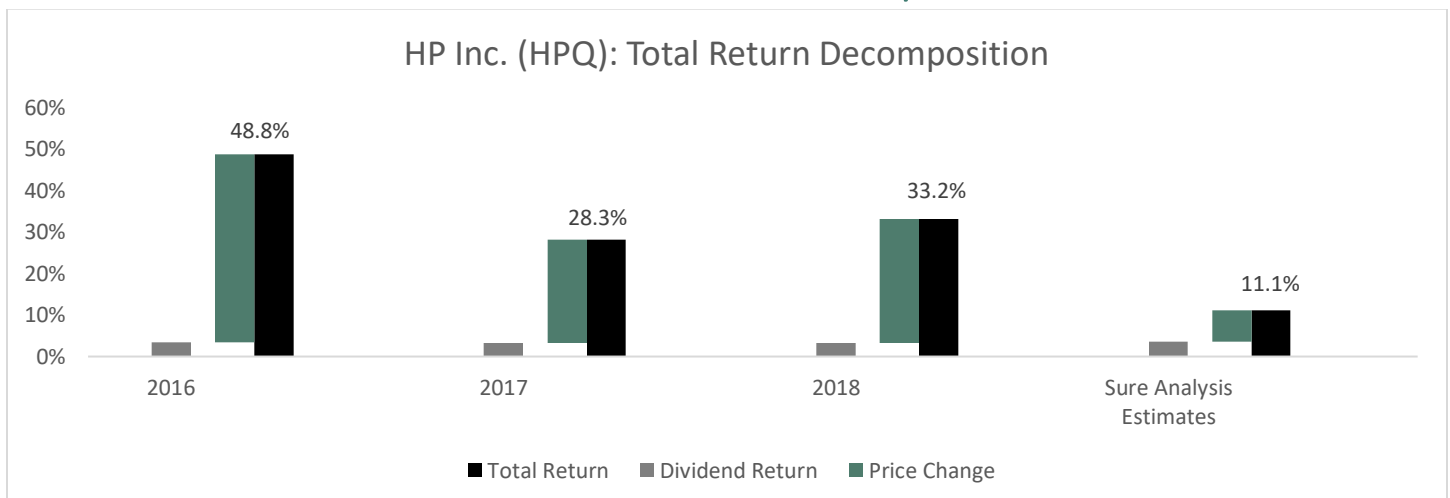
HP has grown its dividend repeatedly during the last couple of years, but there is no long-term data. The dividend looks quite safe today, as it is easily covered by both profits and cash flows. HP pays out a large amount of cash to its owners via share repurchases, which have been one of the growth drivers for earnings-per-share growth in the past. Share repurchases could be scaled back if cash flows and profits were to take a hit, so the dividend could be maintained.

HP enjoys competitive advantages as a leader in its two legacy businesses. The long-term viability of these markets is unknown to some extent, but for now HP owns a \$3+ billion annual underlying profit machine. HP could be a major beneficiary of consolidation in the industry, and thanks to its strong balance sheet and ample cash flows, it could easily become an acquirer of competing businesses. Things can change quickly in technology, so it makes sense for HP to have the resources available to buy its way into the next trend if there is a strategic fit.

Final Thoughts & Recommendation

There is a possibility that HP's legacy business may ultimately decline, but for the moment the company's profit generation is impressive. In addition, HP has ways to grow, both organically as well as via M&A. HP's shares are trading at an inexpensive valuation and offer an above-average dividend yield. Coupled with some earnings growth, shares could provide compelling total returns going forward, which is why we rate the stock a buy.

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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