



HP Inc. (HPQ)

Updated December 3rd, 2020 by Jonathan Weber

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|----------------------------------|----------|
| Current Price: | \$23 | 5 Year CAGR Estimate: | 10.5% | Market Cap: | \$32B |
| Fair Value Price: | \$26 | 5 Year Growth Estimate: | 5.0% | Ex-Dividend Date: | 12/08/20 |
| % Fair Value: | 88% | 5 Year Valuation Multiple Estimate: | 2.5% | Dividend Payment Date: | 01/06/21 |
| Dividend Yield: | 3.4% | 5 Year Price Target | \$33 | Years Of Dividend Growth: | 10 |
| Dividend Risk Score: | C | Retirement Suitability Score: | C | Last Dividend Increase: | 10.0% |

Overview & Current Events

Hewlett-Packard's story goes back to 1935 with two men 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. has centered its business activities around two main segments: its product portfolio of printers, and its range of so-called personal systems, which includes computers and mobile devices.

HP reported its fourth quarter (fiscal 2020) results on November 24. The company reported revenue of \$15.3 billion for the quarter, which was easily more than what the analyst community had forecasted, but still down 1% from the previous year's quarter. The coronavirus crisis did not have a large impact during the quarter, as weakness in the corporate segment was offset by higher revenues from the consumer business.

Non-GAAP earnings-per-share totaled \$0.62 per share during the fourth quarter, which beat the analyst consensus estimate easily. Earnings-per-share were up by 3% versus the prior year's quarter. The company currently forecasts earnings-per-share in a range of \$0.64 to \$0.70 for the first quarter, which would mean more progress in improving profitability on a sequential basis. Since customers are only pushing back purchases of new printers etc., but these items will eventually be bought, the coronavirus impact will likely be negligible in the long run. Thanks to a strong consumer business during recent quarters, HP managed to grow its profits slightly during fiscal 2020 compared to pre-crisis levels, and buybacks played a role in that. It is expected that profits will continue to climb during the current year.

Growth on a Per-Share Basis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---------------------------|------|------|------|------|------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS | --- | --- | --- | --- | --- | \$1.53 | \$1.48 | \$2.02 | \$2.24 | \$2.28 | \$2.60 | \$3.32 |
| DPS | --- | --- | --- | --- | --- | \$0.37 | \$0.52 | \$0.55 | \$0.64 | \$0.70 | \$0.78 | \$1.04 |
| Shares¹ | --- | --- | --- | --- | --- | 1,712 | 1,650 | 1,570 | 1,490 | 1,360 | 1,300 | 1,150 |

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 2020, while also ramping up its dividend payments during that time.

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 2017 to 2019 likely will not be replicated forever, as some one-time items such as tax law changes impacted results positively. 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. Even without any meaningful business growth, corporations can still generate growth on a per-share basis through the use of shareholder return programs. Through a rapid pace of share repurchases, HP has a good chance of growing its earnings-per-share meaningfully going forward, showcased by the reduction of around 20% in its share count between 2016 and 2020.

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 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Now | 2026 |
|-----------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| Avg. P/E | --- | --- | --- | --- | --- | 8.3 | 12.0 | 11.3 | 8.0 | 7.9 | 8.8 | 10.0 |
| Avg. Yld. | --- | --- | --- | --- | --- | 3.9% | 3.0% | 2.4% | 3.6% | 3.9% | 3.4% | 3.1% |

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 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 look slightly undervalued at the current price, which should result in some total return tailwinds going forward.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|--------|------|------|------|------|------|-------|-------|-------|-------|-------|--------------|--------------|
| Payout | --- | --- | --- | --- | --- | 24.2% | 35.1% | 27.2% | 28.6% | 30.7% | 30.0% | 31.5% |

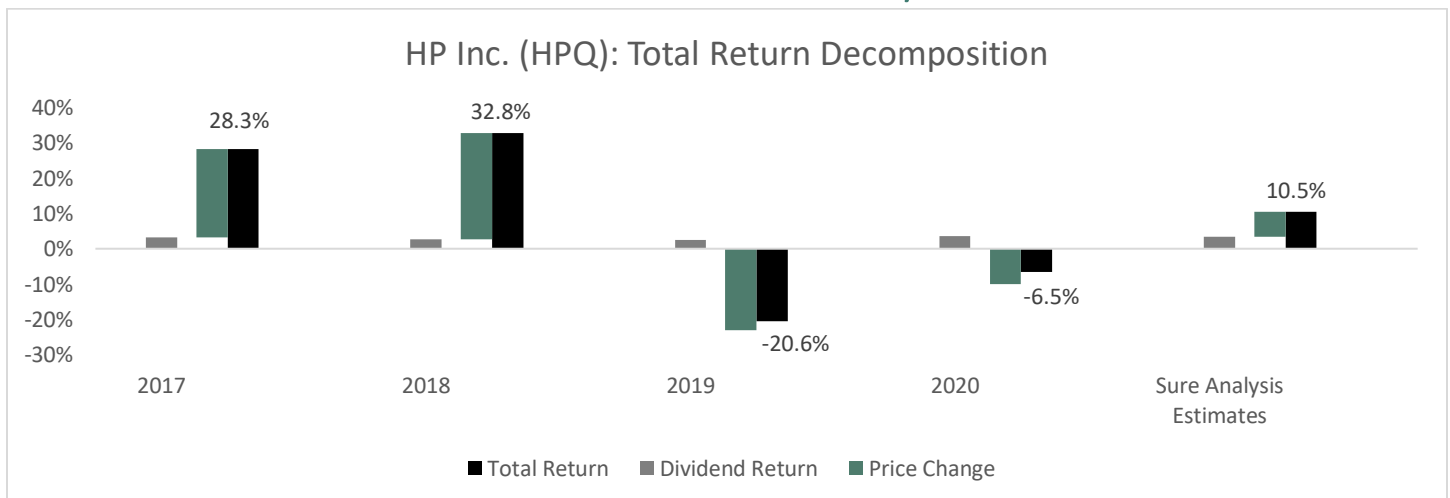
HP has grown its dividend repeatedly during the last couple of years, but there is no long-term data. The dividend looks quite safe today, as it is easily covered by both profits and cash flows. HP pays out a large amount of cash to its owners via share repurchases, which have been a major growth drivers for its earnings-per-share in the past. Share repurchases have been scaled back during the coronavirus crisis, but HP chose to still increase its dividend by 10% in November.

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 very solid. 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. It looks like the coronavirus crisis will not impact HP in a meaningful way, and thanks to solid forecasted returns, we rate the stock a buy.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|-------------------------|--------|---------|--------|-------|-------|-------|-------|--------|-------|-------|
| Revenue | 127245 | 120357 | 112298 | 56651 | 51463 | 48238 | 52056 | 58472 | 58756 | 56639 |
| Gross Profit | 29827 | 27972 | 25918 | 11220 | 9939 | 8998 | 9578 | 10669 | 11170 | 10437 |
| Gross Margin | 23.4% | 23.2% | 23.1% | 19.8% | 19.3% | 18.7% | 18.4% | 18.2% | 19.0% | 18.4% |
| SG&A Exp. | 13577 | 13500 | 13267 | 5361 | 4719 | 3833 | 4532 | 5099 | 5368 | 4906 |
| D&A Exp. | 4984 | 5095 | 4611 | 4334 | 4061 | 332 | 354 | 528 | 744 | 789 |
| Operating Profit | 11389 | 9289 | 8143 | 4432 | 3927 | 4412 | 3902 | 3424 | 3001 | 3940 |
| Op. Margin | 9.0% | 7.7% | 7.3% | 7.8% | 7.6% | 9.1% | 7.5% | 5.9% | 5.1% | 7.0% |
| Net Profit | 7074 | (12650) | 5113 | 5013 | 4554 | 2496 | 2526 | 5327 | 3152 | 2844 |
| Net Margin | 5.6% | -10.5% | 4.6% | 8.8% | 8.8% | 5.2% | 4.9% | 9.1% | 5.4% | 5.0% |
| Free Cash Flow | 8100 | 6865 | 8409 | 8480 | 3423 | 2819 | 3275 | 3982 | 3983 | 3736 |
| Income Tax | 1908 | 717 | 1397 | 939 | (186) | 1095 | 750 | (2314) | (629) | 387 |

Balance Sheet Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|-------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Total Assets | 129517 | 108768 | 105676 | 103206 | 106882 | 28987 | 32913 | 34622 | 33467 | 34681 |
| Cash & Equivalents | 8043 | 11301 | 12163 | 15133 | 7584 | 6288 | 6997 | 5166 | 4537 | 4864 |
| Acc. Receivable | 18224 | 16407 | 15876 | 13832 | 4825 | 4114 | 4414 | 5113 | 6031 | 5381 |
| Inventories | 7490 | 6317 | 6046 | 6415 | 4288 | 4484 | 5786 | 6062 | 5734 | 5963 |
| Goodwill & Int. | 55449 | 35584 | 34293 | 33267 | 5680 | 5622 | 5625 | 6421 | 7033 | 6380 |
| Total Liabilities | 90513 | 85935 | 78020 | 76079 | 78731 | 32876 | 36321 | 35261 | 34660 | 36909 |
| Accounts Payable | 14750 | 13350 | 14019 | 15903 | 10194 | 11103 | 13279 | 14816 | 14793 | 14704 |
| Long-Term Debt | 30634 | 28436 | 22587 | 19525 | 8871 | 6813 | 7819 | 5987 | 5137 | 6217 |
| Total Equity | 38625 | 22436 | 27269 | 26731 | 27768 | (3889) | (3408) | (639) | (1193) | (2228) |
| D/E Ratio | 0.79 | 1.27 | 0.83 | 0.73 | 0.32 | (1.75) | (2.29) | (9.37) | (4.31) | (2.79) |

Profitability & Per Share Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|-------------------------|-------|--------|-------|-------|-------|-------|-------|--------|-------|-------|
| Return on Assets | 5.6% | -10.6% | 4.8% | 4.8% | 4.3% | 3.7% | 8.2% | 15.8% | 9.3% | 8.3% |
| Return on Equity | 17.9% | -41.4% | 20.6% | 18.6% | 16.7% | 20.9% | | | | |
| ROIC | 10.7% | -20.9% | 10.1% | 10.3% | 10.9% | 12.5% | 68.9% | 109.2% | 67.8% | 71.7% |
| Shares Out. | --- | --- | --- | --- | --- | 1,712 | 1,650 | 1,570 | 1,490 | 1,360 |
| Revenue/Share | 59.80 | 60.97 | 57.59 | 29.63 | 28.03 | 27.68 | 30.59 | 35.78 | 38.55 | 39.89 |
| FCF/Share | 3.81 | 3.48 | 4.31 | 4.44 | 1.86 | 1.62 | 1.92 | 2.44 | 2.61 | 2.63 |

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

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