Company Description

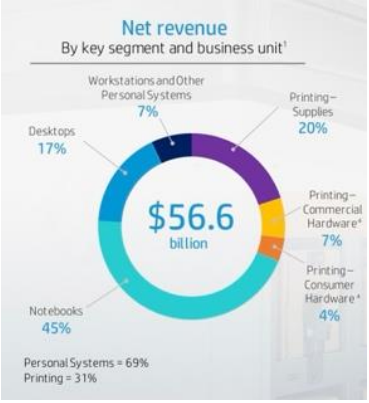
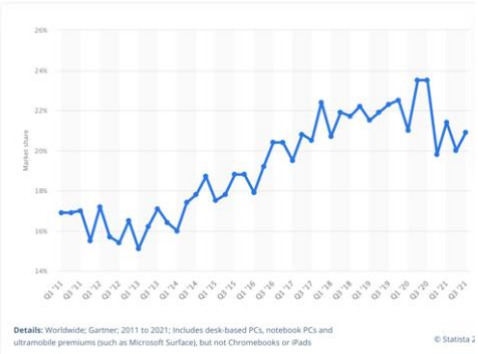


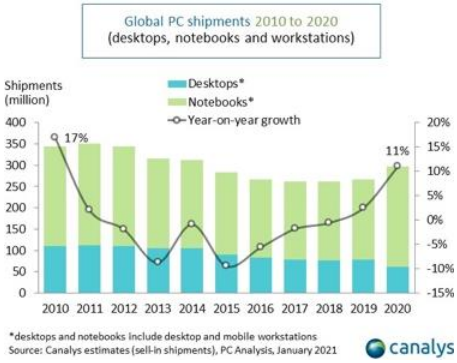
Figure 1: https://www.therecycler.com/posts/hp-confirms-the-razor-and-blades-model-is-changing/

HP Inc. is an American multinational information technology company based in California. It is a leading producer of personal computers (PCs), printers and related supplies. HP is also increasingly offering cybersecurity software and 3D printing solutions. Its clients include private consumers, small and medium enterprises, and large corporations. It is currently the second-largest vendor of PCs by sales. In 2015, the company spun off into Hewlett-Packard Company (HPQ) from Hewlett-Packard Enterprise (HPE), which offered business information technology (IT) solutions. HP has an international presence, with approximately 63% of revenue coming from outside the US in 2016. It also has an outsourced supply chain, which has exposed it to global supply chain shortages in 2021. HP's market share has consistently grown and currently has the **second-largest** share, at 20.9% (2.8% behind Lenovo). Net revenue increased by **12.1%** to $63.5bn in 2021.



Industry Overview

The PC industry grew **11%** in 2020 relative to 2021 from $145.73bn to $161.93bn. The Personal Systems division at HP grew in line with this between 2020-2021. Both surpassed the expectations of Bloomberg Analysts, who predicted industry growth of **8.5%.** This has been driven by several trends that began with the Covid-19 pandemic.



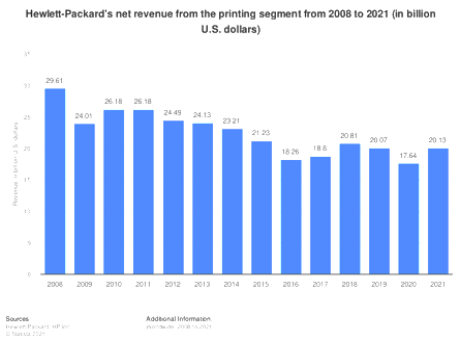
Firstly, the increase in remote working raised consumer demand. Continued restrictions and new variants mean this trend will likely continue into 2022. According to a consumer survey, **67%** of workers are still working at home. Moreover, analysis by Deloitte indicates that a hybrid working environment is likely to persist even after the pandemic ends.

Secondly, despite an increase in demand of **50%** for computers for education during the pandemic, laptops per 100 students remain in single digits. As such, demand is still well below its expected peak, signalling further growth. HP is well-positioned to absorb demand as the leading provider for education laptops like their HP Envy and the HP Spectre x360.

Business Overview

HPQ has two main business divisions: Personal Systems and Printing.

In Printing, it is a market leader in printer hardware, supplies and related services, with a market share of **24.5%.** The pandemic initially hit revenue, which fell from $4.98bn to $4.83bn, while profits fell by **8.2%** from $777mn in Q4 2019 to $713mn in Q4 of 2020.



Personal Systems offers commercial and consumer desktop and notebook PCs, workstations, thin clients, commercial mobility devices, retail POS systems, displays and other related accessories, software, support, and services. HP has cited facing "aggressive price competition" and "intense innovation" as two main risk factors in this division. They have mitigated this by increasing R&D spending to $1.9bn, bringing the R&D/Revenue ratio to **26%** in 2020. As such, they have maintained revenue growth, which rose **7%** in Q1 2021 to $10.6bn. To capitalise on increasing demand, HP made vital acquisitions such as Teradici in October 2021. This improves their remote-working offerings and adds to a unique selling proposition (USP) that they can cross-sell with products.

HP Inc. reported Q1 2021 revenue and profit that topped Bloomberg analysts' estimates; they were at 84-90 cents Earnings Per Share (EPS) compared to analysts' 61 cents estimate. The CEO has warned on growth being capped due to a supply lag and chipset shortages from Intel's side, straining HP's profits whilst they meet their 2021 PC demand surge.

Financial Analysis

HP has a current market capitalisation of $43bn. They have stayed close to the NYSE market average **dividend yield** of **3.17%** with **2.99%**. Although not ideal, this was primarily due to the pandemic. HP is expected to be resilient, and the CEO has promised to return 100% of free cash flow to investors in 2022.

Given HP's consistent decline in the number of shares outstanding throughout 2017-2020, HP has dealt with the pandemic constraints healthily and has not opted to dilute or buy back its shares and instead maintained consistent dividend yields.

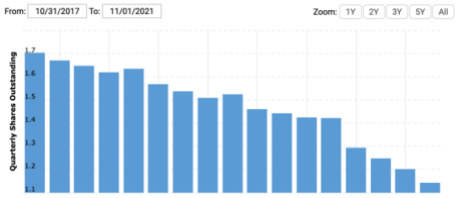


Figure 2: https://www.macrotrends.net/stocks/charts/HPQ/hp/shares-outstanding

HP has a **P/E ratio** of 6.7. This is compared to an average of 12.7 among comparable competitors, indicating that HP is more undervalued than its competitors since its 11% growth is in line with the industry.

HP's 2020 **Net (Profit) Margin** was only **5.36%.** This indicates how hard HP supply chain constraints hit by HP. However, they eventually overcame this, adjusting in 2021. They had sudden factory closures in China & Southeast China, which forced them to work specific factories over time – leading to higher operational costs.

HP's **Free-Cash-Flow (FCF**) has been relatively stable from 2010-2020 with the cash flow to debt ratio being **58.6%** in 2020 and **85.5%** in 2021. This means HP is financially speaking, firmly on the ground. Compared to its competitors, it also has strong sales and earnings. Its Enterprise Value (EV)/Sales Value (SV) is 0.73, which is below the average of 2 and the median of 1 for competitors in 2021. Similarly, HP had a stronger EV/EBITDA value of 7.3 than the industry's at 9.

Competitive Advantage

HP's market-leading position in Printers allows it to leverage its strong client relations. HP is pursuing a subscription model with services like Instant Ink which automatically supplies ink cartridges based on real-time data from printers. The service is worth $500mn, and HP analysts expect **30%** growth before tapering. HP is also investing in additive printing innovation and created over 100m parts to date, selling to various markets like the automotive industry and consumer goods firms like L'Oréal.

HP also has a managerial advantage over its competitors. Their designated "Future Unit" team works to build awareness and model potential doomsday scenarios, pandemics being one of them and asking different departments to create responses for these. Additionally, HP trains employees to be flexible

between 4-6 functional areas via internal training sessions. Malone (2007) stated how HP emphasizes deep analysis of the competition and creates products in return that improve upon their offerings and fix the competitors' customers' pain points, such as the All-in-One HP DeskJet printer.

Risk Analysis

One of HP's main vulnerabilities is its outsourced manufacturing (OM) model for a range of components, exacerbated by the extensive range of non-interchangeable parts that HP orders. According to their SEC filings, this risk is mitigated by "having suppliers across different regions and backup options available".

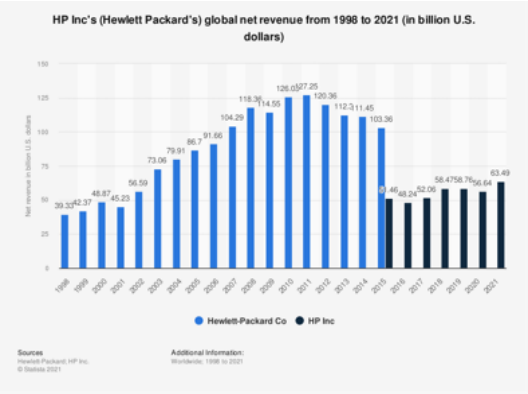
HP and the industry's access to only two chipset providers, AMD and Intel, led to shortages in 2020 and 2021 of chipsets due to factory shutdowns, the US-China trade war, and natural disasters. They faced printing and PC delivery problems. CEO Lores has said HP expects chipset inventories to be constrained until mid-2022 when HP expects supply to catch up. As such, we expect costs to be $5.5bn in 2022. However, in the long-term, HP is addressing its cost structure with a $1bn restructuring plan from 2019 to 2022. As such, we predict lower cost growth into the future.

HP invests heavily in R&D to keep offerings competitive; it was up to **29%** in 2021 compared to 2020's $1.48bn. We expect this to rise as they remain focused on growing the graphics, 3D printing and cybersecurity (HPE) divisions. Meanwhile, HP's restructuring should reduce operational costs elsewhere.

Outlook

We have taken an optimistic approach to our predictions for revenue assumptions based on their historical revenue growth, which we believe HP could surpass if they innovate fast enough.

The four-year average growth rate of HP's revenue from 2017-2021 was **4.1%**. Year-on-year, this has been variable, spanning from +11%, +0.5%, -4.1% (2020), +11% (2021) given the dynamic pandemic. We have estimated growth to be 7% in 2022, as hybrid working continues to boost demand. However, we eventaully expect growth to fall. Given its positive trajectory post-2017 and expected average growth for the industry of **4.5%**, it's possible demand stays positive but tapers off after the effect of the pandemic ends.



Based on this, we conclude that it should have been $41.84 by October 31st 2021, the closing price on December 2nd was $37.64. As such, we give HP a **hold** rating if its stock price at the end of 2021 is between $35 to $47. We believe HP could outperform these expectations. Moreover, if the price falls below $35, we would give HP a buy rating due to its strong business and high returns. However, if the price rises above $47, we would recommend selling.