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HP, Inc. (HPQ)
Q4 2020 Earnings Call
CORPORATE PARTICIPANTS

Beth Howe  
Vice President & Head-Investor Relations, HP, Inc.

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

Marie Myers  
Acting Chief Financial Officer & Chief Transformation Officer, HP, Inc.

OTHER PARTICIPANTS

Kathryn Lynn Huberty  
Analyst, Morgan Stanley & Co. LLC

Toni Sacconaghi  
Analyst, Sanford C. Bernstein & Co. LLC

Amit Daryanani  
Analyst, Evercore Group LLC

Jim Suva  
Analyst, Citigroup Global Markets, Inc.

Shannon Cross  
Analyst, Cross Research

David Vogt  
Analyst, UBS

Rod Hall  
Analyst, Goldman Sachs & Co. LLC

Matthew Cabral  
Analyst, Credit Suisse Securities (USA) LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the HP Inc. Fourth Quarter 2020 Earnings Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Beth Howe, Head of Investor Relations. Please go ahead.

Beth Howe  
Vice President & Head-Investor Relations, HP, Inc.

Good afternoon, everyone, and welcome to HP's fourth quarter 2020 earnings conference call. With me today are Enrique Lores, HP's President and Chief Executive Officer; and Marie Myers, HP's Acting Chief Financial Officer.

Before handing the call over to Enrique, let me remind you that this call is being webcast. A replay of this webcast will be made available on our website shortly after the call for approximately one year.

We posted the earnings release and the accompanying slide presentation on our Investor Relations webpage 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 related to forward-looking statements that involve risks, uncertainties, and assumptions. For a discussion of some of these risks,
uncertainties, and assumptions, please refer to HP’s SEC reports including our most recent Form 10-K and Form 10-Q. 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 Form 10-K for the year ended October 31, 2020 and HP’s other SEC filings. During this webcast, unless otherwise specifically noted, all comparisons are year-over-year comparisons with the corresponding year ago period.

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 earnings release for those reconciliations.

And now, I’ll turn it over to Enrique.

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

Thank you, Beth, and thank you everyone for joining the call today. It remains a difficult time for so many across the world. I hope you and your families are safe and healthy.

Today, I will recap our strong Q4 and full year financial results, and I will discuss the significant progress against our advance, disrupt, and transform strategy.

Let me start with the strength of Q4 where we drove improvement relative to the third quarter in revenue, operating profit, non-GAAP EPS, and cash flow. We are encouraged by the signs of improvement in our business as we continue to navigate a dynamic macro environment.

For the quarter, we delivered revenue of $15.3 billion, flat year-over-year in constant currency. Non-GAAP EPS of $0.62, up 3% year-on-year, and we generated free cash flow of $1.8 billion. For fiscal 2020, despite the pandemic, we delivered on the full year non-GAAP EPS and cash flow outlook we gave at our Analyst Day last year.

For the full fiscal year, we delivered revenue of $56.6 billion and non-GAAP EPS of $2.28. In addition, we generated strong free cash flow of $3.9 billion, and we returned $4.1 billion to shareholders through share repurchases and dividends while making appropriate investments in the business.

Looking at our performance, two themes stand out that are consistent across both Print and Personal Systems. HP’s broad and differentiated portfolio and leadership across Consumer and Commercial market makes our company more resilient across business cycles. And secondly, our operational execution including our disciplined pricing, strategic cost reductions, and supply chain agility help us navigate in a very dynamic environment.

Underpinning it all is a purpose-driven culture built on strong corporate values. Our founders used to say that the greatest competitive advantage is doing the right thing at the worst time, and our teams have lived up to this ideal through a tremendously difficult year, consistently stepping up to do the right things for our business, our customers, and our communities around the world. This is who we are as a company, and I could not be more proud.

Now, let me turn to our business and review the progress we have made against our strategy. We are advancing our leadership in our core market and expanding our reach into profitable adjacency. We are positioning our sales
to disrupt new markets where our technologies and IP present significant opportunities to create and scale new businesses over time, and we are transforming the way we operate across the company with a focus on building out our cloud infrastructure and our digital capabilities while reducing our cost structure.

Our progress can be seen in each of our business units. It was another strong quarter for Personal Systems with revenue of $10.4 billion and a record 19 million units shipped. We grew Consumer revenue 24% with Consumer premium up 29%, and Consumer displays and accessory up 59%. Chromebook revenue and units more than doubled.

We exited the quarter with an elevated backlog and continue to operate with component supply shortages which are expected to constrain our growth through the first half of 2021. The PC is more essential to daily life than ever before, and demand for our innovation remains strong.

We launched a range of new products in our core compute categories last quarter. To meet the needs of professional creators and owners that require uncompromising mobile computing performance, we unveiled our new ZBook Studio Mobile Workstations. We also announced a new lineup of HP ProBook and HP Spectre x360, and we expanded our Chromebook and mobile thin client portfolios.

And as PC gaming continues to surge in popularity, we debut a range of new OMEN accessories including the OMEN Frequency Wireless Headset, OMEN Vector Wireless Mouse, and OMEN Spacer Wireless Keyboard. This momentum in gaming accessories reflects our broader focus and innovating and important adjacencies, including peripherals and services.

During the second half of this year, we introduced a number of new monitors to improve the work-from-home experience, including always-on low blue light to reduce eye strain, and displays with increased touch capability. And we expanded our services offerings, including a new Device as a Service bundle specifically designed to simplify life for small and medium businesses.

We expect to see continued PC unit growth in 2021, which we anticipate will create additional opportunities for us to drive profitable growth as well as grow the lifetime value of our install base by broadening our ecosystem of peripherals and services.

Turning to Print, I am very pleased with the sequential growth in revenue, profit, supply, and unit shipments. In Q4, the Printing business generated revenue of $4.8 billion and operating profit of $713 million. We delivered a strong quarter relative to the market conditions.

COVID-related effects on both supply and demand have continued to impact our Printing results. From a demand perspective, ongoing demand for Consumer hardware and supplies, combined with disciplined pricing, substantially offset the decline in Commercial Print. And from a supply perspective, while we began to replenish stock at our partners, we anticipate continued supply constraints on some Consumer hardware and supplies SKUs.

HP is outperforming its peers and remains uniquely well-positioned, given our leadership across both Consumer and Commercial Print. Our strong Consumer business is a clear advantage for us as the shift to remote work and school continues to create momentum in home printing.

We also saw some progress in Commercial Print driven by the SMB sector. We expect a gradual recovery in the overall Commercial Print market. The recovery may be uneven, given the varying pace of economic recovery and
the resurgence of COVID-19 cases in some countries. And we expect that the strength in home will gradually subside when more offices and schools reopen.

We continue to evolve our Print business models with our drive toward services and a rebalance of profitability between hardware and supply. Our Instant Ink subscription business continued to see rapid growth, with subscribers up double-digits, surpassing our target of 8 million enrollees.

We are making progress on rebalancing the business model between hardware and supplies. We are expanding profit up front with 69% unit growth on CISS or Big Ink. We have improved Consumer hardware ARU year-over-year through selective price increases, new product innovations and lower discounts. And earlier this month, we began the rollout our much anticipated end-to-end platform strategy that we discussed at SAM last year.

HP+, our end-to-end system, provides a differentiated value proposition for our loyal customers. We plan to extend HP+ across most of our home and more office portfolio in developed market as we roll out new products. Together, we expect these actions will help us to optimize the business by reducing the number of unprofitable customers.

We are also making progress against our plans to disrupt industry with our technology solutions and IP to drive medium to long-term value creation. While the industrial businesses of graphics and 3D continue to be impacted by lower business activity due to the pandemic, we saw sequential improvement in both businesses as well as growth in strategic markets.

In labels and packaging, for example, we had significant new systems wins at ePac for flexible packaging and BoxMaker for corrugated boxes, and impressions and square meters increased double-digit year-over-year. In 3D, we continue to shift our focus toward more end-to-end solutions and higher-value applications.

For example, this quarter, we launched a new tooling solution to disrupt the molded fiber packaging sector. Molded fiber packaging covers thousands of products ranging from food and beverage containers to packaging for household goods and consumer electronics. We are excited for the disruptive potential in this sector as our innovative technology opens up entirely new possibilities.

We are doing all of this while transforming the way we work to unlock value and become a leaner, more digitally enabled company. We have delivered on the foundational milestones that we outlined previously, and we are well ahead of our cost savings target this year. We have significantly reduced structural costs, driven productivity savings and enabled enhanced digitization. Marie will go into more detail in a few minutes. And we are still in the early days of our transformation.

The progress we made in fiscal year 2020 is indicative of the opportunities we see in fiscal 2021 and beyond. This will remain a big area of focus as we continue to drive digital transformation and efficiency across the organization to position the business for growth. Let me sum up by reiterating the strength of our position as we enter fiscal 2021.

A powerful blend of innovation and execution is driving our business forward. We have a diverse and resilient business model, are leading in our core market, investing appropriately in attractive growth opportunities and taking the steps necessary to transform for the future.

We remain committed to generating strong cash flow and to value-creating capital allocation. This includes our robust share repurchase and dividend program and disciplined organic and inorganic investments.
We will continue to lead with our values of making a sustainable impact in the world, including stepped up efforts to support diversity, equity and inclusion, as well as to reduce our environmental footprint and mitigate the growing threat of climate change. These are business imperatives where we have a deep and unwavering commitment.

Before turning the call over to Marie, let me share some details on her background. Marie is both our Chief Transformation Officer and our Acting CFO. She is a veteran of HP, having held a number of leadership positions at the company, including as our Controller.

Prior to returning to HP earlier this year, she was CFO at UiPath. And as Chief Transformation Officer, her leadership has been integral to the cost savings we have delivered over the past year. I’m really grateful to have her leading finance through this transition.

I’ll now pass it to Marie to review the financials.

Marie Myers  
 Acting Chief Financial Officer & Chief Transformation Officer, HP, Inc.

Thank you, Enrique, for the kind introduction. It’s great to be with all of you today.

Q4 was a strong finish against a tough 2020 backdrop. With that said, our performance reflected the company’s multiple profit levers, solid execution, and resiliency. Before diving further into Q4, let me quickly recap FY 2020 for the full year.

We delivered revenue of $56.6 billion, down 2% in constant currency. We grew non-GAAP EPS 2%, which continues our trend of growing non-GAAP EPS every year since separation. We generated $3.9 billion of free cash flow, above our full year guidance, and we returned $4.1 billion or 105% of free cash flow to shareholders. Importantly, we’ve delivered these results while investing in our business for future growth and efficiency during the global pandemic. Our foundation is strong, including our balance sheet, and we have multiple levers to create value for our shareholders.

Now, let’s look at the details of the fourth quarter. Q4 net revenue was $15.3 billion, down 1% year-on-year or flat in constant currency. Regionally, in constant currency, Americas increased 4%, EMEA decreased 1%, and APJ decreased 6%. Gross margin was 17.6%, down 1.4 points year-on-year. The decline was due to a combination of a higher consumer mix within both Personal Systems and print hardware and lower rate in commercial print.

Non-GAAP operating expenses were $1.6 billion, down $169 million. The decline in operating expenses was driven by our ongoing cost efficiency program as part of our transformation efforts as well as a reduction in discretionary costs.

Non-GAAP net OI&E expense was $60 million for the quarter. Non-GAAP diluted net earnings per share increased 3% to $0.62, with a diluted share count of approximately 1.4 billion shares.

Non-GAAP diluted net earnings per share excludes a net expense totaling $167 million related to one-time defined benefit plan settlement charges, amortization of intangible assets, restructuring and other charges, and partially offset by non-operating retirement-related credits and other tax adjustments. As a result, Q4 GAAP diluted net earnings per share was $0.49.
Turning to segment performance, in Q4, Personal Systems benefited from solid demand related to working and learning from home, with revenue of $10.4 billion, flat as reported, or up 1% in constant currency. Our top line remained constrained due to industry-wide supply shortages in CPUs and panels.

Drilling into the details, we saw differing results by customer segment, with Consumer revenue up 24% while Commercial revenue was down 12%. By product category, revenue was up 18% for Notebooks, down 28% for Desktops, and down 45% for Workstations. The change in mix reflected the strong demand for Notebooks, mainly in Chromebooks, which represented 20% of our total Personal Systems units as working and learning from home continued.

Personal Systems delivered $528 million in operating profit and operating margins of 5.1%, in line with our outlook and at the higher end of our long-term range of 3.5% to 5.5%. Our results reflected the impact of a higher Consumer segment mix within our portfolio and lower commercial rate, which were partially offset by cost reductions.

In Print, our results reflected strong execution and the team’s agility as we continued to see a trade-off in demand between home and office print due to the pandemic. Within Commercial office print, we did see some improvement driven by SMB. Importantly, HP remains uniquely well-positioned in the print market by being a leader across both home and office with portfolio depth and resiliency to navigate these uncertain times. Q4 total Print revenue was $4.8 billion, down 3% nominally and 2% in constant currency.

By Customer segment, Consumer hardware revenue was up 21%, with units up 18% and Commercial Hardware revenue was down 22% on a 10% reduction in units. In total, hardware units were up 14% to 11.8 million units, a record since we became a separate company.

Supplies revenue was $3.1 billion, flat in constant currency. In the fourth quarter, lower commercial printing was offset by consumer demand due to work and learn from home, and disciplined pricing as well as replenishment of stock at our channel partners as product availability improved. Tier 1 channel inventory levels remain below the ceiling.

Print operating profit was $713 million and operating margins were 14.8%. The year-over-year decline was due to lower commercial print hardware rate and strong Consumer hardware shipments, partially offset by a strong supplies performance and OpEx reductions.

Now, let me turn to our cost savings and transformation efforts. We finished FY 2020 ahead of the first year cost reduction target, which is 40% of our three-year $1.2 billion gross run rate structural cost reduction plan. During this dynamic environment, we are also reducing discretionary costs as much as possible even though they are more temporary in nature. To illustrate, we've seen significant operating expense reductions throughout the year, with Q4 non-GAAP OpEx as a percentage of revenue at 10.7%.

We are focused on continuing to dive deeper into our transformational efforts. As an example, in FY 2020, we have taken site optimization actions by exiting over 30 real estate sites to align with our location and mobility strategy. In addition, we have seen efficiency improvement in our customer service and support, driven by our continued shift to digital, which resulted in an over 300% year-over-year increase in virtual agent interactions in the second half of 2020.

Finally, we continued to make progress in our new partner program, Amplify, which we announced last quarter to enable enhanced data analytics and provide partners with the capabilities, tools, and insights required to
capitalize on opportunities across the portfolio. As we head into FY 2021, we are focused on further digital enablement and driving a lean cost structure because we believe it enables top and bottom line growth.

Shifting to cash flow and capital allocation, Q4 cash flow from operations and free cash flow were strong at $1.9 billion and $1.8 billion, respectively. The stronger than expected cash flow was driven by higher earnings and contributions from working capital. For Q1, we expect free cash flow to be softer than Q4, in line with typical seasonal patterns.

In Q4, the cash conversion cycle was minus 30 days. Sequentially, the cash conversion cycle was flat as normalized purchasing and sales drove decreases in days of inventory and days sales outstanding, offset by decreases in days payable outstanding.

We returned $1.3 billion to shareholders through share repurchases and $238 million via cash dividends in Q4. For the year, we have returned a total of $4.1 billion, which represented 105% of free cash flow and a year-over-year increase of 22%.

Today, we announce that we are increasing our dividend by 10%. Looking forward, we expect to continue buying back shares at elevated levels of at least $1 billion per quarter in the coming quarters.

Heading into Q1, keep the following in mind related to our overall financial outlook. We expect macroeconomic conditions to be more uncertain as the impact of the COVID-19 pandemic continues to evolve.

Turning to specific Personal Systems assumptions, our backlog remains elevated and higher than the previous quarter but we expect industry-wide CPU panel and semiconductor constraints to continue to negatively impact our ability to meet demand, especially for Notebooks, which will constrain top line growth.

We expect continued strong demand in consumer and education pressure in Commercial, particularly Desktops and Workstations. We expect the costs from the overall basket of commodities to be similar to Q4 levels, and from a margin perspective, we expect Q1 operating margins to be similar to Q4.

In Printing, from a demand perspective, due to the pandemic, we expect to continue to see the positive demand for home printing offset by more competitive pricing in home printing as well as continued economic pressure on commercial printing. We expect to continue to navigate the supply constraints with a focus on appropriately replenishing stock so that our partners are well-positioned to satisfy demand. We expect our operating margin for Q1 to get into the long-term range of 16% to 18%.

Taking these considerations into account, we are providing the following guidance for Q1. We expect first quarter non-GAAP diluted net earnings per share to be in the range of $0.64 to $0.70 and first quarter GAAP diluted net earnings per share to be in the range of $0.58 to $0.64.

And now, I would like to hand it back to the operator and open the call for your questions.
QUESTION AND ANSWER SECTION

Operator: And we’ll now begin the question-and-answer session. [Operator Instructions] Our first question today comes from Katy Huberty with Morgan Stanley.

Kathryn Lynn Huberty  
Analyst, Morgan Stanley & Co. LLC

Thank you. Good afternoon and congrats on the quarter. The recovery in Printing revenue was particularly impressive, especially with supplies revenue getting back to flat year-over-year in constant currency, but the operating margin was below your long-term range and you’re talking about getting back to that 16% to 18% operating range in the first quarter.

So just curious what held operating margin back in the fourth quarter, and what are the factors allowing you to expand margins sequentially going into the fourth quarter. And then I have a – or the first quarter and then I have a follow-up.

Marie Myers  
Acting Chief Financial Officer & Chief Transformation Officer, HP, Inc.

So thank you, Katy, and good afternoon. So let me provide you with some color around the Print OP rate in Q4. So, first of all, I’d start out by saying, look, we had strong Consumer hardware unit placements, which, as you know, have negative margins upfront, coupled with the softness in commercial parts of our business, such as graphics and 3D. Combined with lower volumes and higher costs, we’re absorbing those costs across the portfolio. Plus, there has been some volatility that we experienced in our supply chain which resulted in some additional costs in the quarter and also in areas such as logistics, where we had a higher mix of air shipments. So the Print OP rate was also partially offset by supplies volume and pricing discipline. And in summary, that’s what drove that decline in the rate in the quarter.

As we look forward to Q1, there are some headwinds and tailwinds on cost and we do expect that there will be some higher logistics costs, particularly we’re using a sort of a stronger mix of air, but we do have some one-time related COVID supply chain costs that we expect will be lower going into Q1.

Kathryn Lynn Huberty  
Analyst, Morgan Stanley & Co. LLC

Okay, great. And then appreciate you don’t guide the revenue, but if we think about the PC and Print revenue trends heading into the fiscal first quarter, what do you think those will look like relative to historical first quarter seasonality?

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

Hi, Katy. Thank you for the question. We expect most of the trends that we saw in Q4 to continue during Q1. If you look at the comment we made during the prepared remarks, we have seen very strong demand on the Consumer side of both Print and Personal Systems, strong demand of Notebooks. We expect this to continue, while we also expect some of the limitations that we have from a supply chain perspective because of availability of components to stay at least through the first half of next year. These are the kind of the key trends from the revenue side.
Kathryn Lynn Huberty  
Analyst, Morgan Stanley & Co. LLC

Thanks.

Operator: Our next question comes from Toni Sacconaghi with Bernstein.

Toni Sacconaghi  
Analyst, Sanford C. Bernstein & Co. LLC

Yes, thank you. You commented a couple of times about a restock in Printing, and I'm wondering if you can elaborate on specifically where, what magnitude and what parts of Print supplies versus Consumer or Commercial Hardware that was? It does look like the US uniquely accelerated its growth rate in the quarter, whereas Europe and Asia were kind of flat to down. So was this rebuild in supply for channel partners largely centered in the US? And I have a follow-up, please.

Marie Myers  
Acting Chief Financial Officer & Chief Transformation Officer, HP, Inc.

Hi, Toni. Good afternoon and thanks for your question. Let me unpack the piece specifically around supply channel inventory. So there are a few drivers and there's a few different things going on in the quarter, so let me give you some context here. So first of all, consumer demand, as you know, was being driven by this whole work and learn from home due to the COVID pandemic. It was offset by lower commercial printing, but in addition we had better discipline in pricing in the quarter that was significant.

And to put it in context, there were supply chain disruptions that we experienced earlier in the pandemic. And we've been doing some replenishment of our stock at channel partners in Q4 to help meet some of that demand from our customers, and we do expect to see that in Q1 as well.

And just in closing, finally, in supplies, we are below ideally where we'd like to be in terms of being below our ceiling on channel inventory. And maybe I'll turn it over to Enrique to give some context about the...

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

Yeah. Let me address your comment about geographies, Toni, because when we look both at PC and printers on both hardware and supplies, our performance this quarter was more driven by supply chain than by demand. We are still limited in many of these categories from a supply chain perspective, and the performance differences that you saw across regions were driven by how we allocate a product, not by where demand was coming from. We had very strong demand on the consumer front for PCs and for printers for every geography of the world.

Toni Sacconaghi  
Analyst, Sanford C. Bernstein & Co. LLC

Okay. Thank you for that. I'm going to use my follow-up to push a little bit on my first question. The supplies growth rate going from minus high-teens to essentially flat seems extraordinary, and it almost feels like in prior quarters you drew down channel inventory. So that exacerbated how poor supply was because you didn't have availability. And this quarter, you replenished it. And all investors care about is what is normalized supplies growth going forward. So it would be really helpful if you could speak to specifically how much restocking improved your supplies growth rate this quarter. And when we look to 2021, what is a realistic supplies growth rate for the year?
Thank you for the question, Toni. As you know, we are not guiding anymore on supplies, but let me give you some color that, I think, will help you to understand in more depth what Marie was explaining before.

During Q2 and Q3, we experienced some supply chain shortages that reduced our ability to supply demand to many of our key resellers. And this, definitely during Q4, demand has continued to be very strong on the consumer side and resellers have replenished their stock. This has been a tailwind for us in the business.

We expect this to continue in the early part of 2021 because we continue to see very strong demand on the Consumer side of supplies. This Consumer demand is really driven by people working from home and kids learning from home, which we also think is going to continue still for a few quarters, which is one of the reasons why our guide for Q1 was stronger than what market was expecting because we expect to see this to continue happening.

And finally, another element of the performance in supplies this quarter were the discipline in pricing that we drove. You probably have noticed that given the availability issues, we have removed promotions. There are very few promotions happening with HP supplies and this, combined with very disciplined pricing with – across the world, has also had a positive impact on revenue – on supplies revenue this quarter. And again, some of it will continue – we expect to continue in Q1.

Operator: Our next question comes from Amit Daryanani with Evercore.

Amit Daryanani
Analyst, Evercore Group LLC

Yeah. Thanks for taking my question. Congratulations on a nice print quite literally from you guys.

I guess my first one is on free cash flow. Yeah, the performance here, I think, in October quarter certainly much better than what most of us had modelled. So I’d love to understand, how did October quarter free cash flow stack up versus your expectations? And I guess when I think about the underlying levers behind the free cash flow, was there any pull in from the early part of next year that sort of helped you guys out? So would love to understand the levers behind the free cash flow strength and any sense on how we should think about qualitatively or quantitatively about fiscal 2021 free cash flow.

Marie Myers
Acting Chief Financial Officer & Chief Transformation Officer, HP, Inc.

Sure. Amit, good afternoon. Look, first off, I'll start out by saying, look, we're really pleased with our results here and what we saw in the quarter. As you know, we drove $1.8 billion free cash flow in Q4 and $3.9 billion in FY 2020, and it was a record actually in a single quarter since the split. So, that cash flow strength that you saw was really stronger than expected due to higher earnings and, frankly, the benefits of working capital, particularly in inventory and AP. And as you know, as we look forward into 2021, I'd just keep in mind that typically, our Q1 cash flow is usually lower given normal seasonality.

Enrique Lores
President, Chief Executive Officer & Director, HP, Inc.
As Marie was saying, the key drivers of free cash flow in Q4 were the strong earnings that we had, and the benefit from working capital that really in many cases driven by the strength of our Personal Systems business that we have commented before. And we are very pleased not only with the results of Q4 but really with the result of the full year where we have delivered the cash flow – the free cash flow that we expected to see before the pandemic and that we shared with all of you in our investor meeting a year ago.

Amit Daryanani  
*Analyst, Evercore Group LLC*

Got it. And then if I could just follow-up on the supplies side, obviously the performance is much better than what I think what you're seeing in the industry or your peers are seeing, but I'd love to understand, I mean, is there a bigger share gain dynamic or even a better mix dynamic? Because you've talked about consumer and SMB a fair amount, and I would imagine they tend to skew more ink-heavy, which might be much better for HP versus not.

So could you just maybe talk about is the mix shifting and that's perhaps giving you better sustainability for supplies as we go forward? Would love to just get better sense over there.

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

Let me explain the dynamics that we are seeing in the Print side. You know we have two strong businesses in Print, Commercial, and Consumer, and our Consumer business is getting a lot of benefit from people working from home, kids learning from home, and this had driven a strong demand for printers and strong demand for supplies. Usage is above the expectations that we had before the pandemic started, and this is clearly having a positive impact in our business.

On top of that, you know that our competitive position is relatively stronger in the home side. We have higher share of printers, higher share of supplies, higher share of pages. So as more demand goes to consumer and to home, we clearly get a benefit from that.

On the Commercial side, we continue to see the impacts of the pandemic. The Printing volumes continue to be significantly below where they were before the pandemic. Through the quarter, we have seen some improvement, but clearly on the Commercial side, still the pandemic is having a strong negative impact.

**Operator:** Our next question comes from Jim Suva with Citigroup.

Jim Suva  
*Analyst, Citigroup Global Markets, Inc.*

Thank you very much and congratulations on the results. I just have one question and you can just answer it in any manner you want, but the average life of a PC and also printers, it used to be kind of pretty consistent, I believe, around four years. Now that we're in a world of coronavirus and splitting time from school, at-school and school-at-home and work-at-work and work-at-home, any thoughts about the average life of the PC? Will it be longer or shorter because you're using it in two different locations, or how should we think about that as we go forward?

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

Let me answer both what we are seeing for both PCs and Print. In the case of PCs, more than the life of PCs changing, what we are seeing is a significant increase in the demand of PCs. PCs have become essential. People
need it for working, for learning, for gaming, for entertaining, for communicating. And the trend that we see is that for every person to have their own PC, and this is really driving significant demand on the PC side.

On the printer side, what is happening is both we're seeing the additional demand for home printers as people and kids are learning and working from home, but we have also seen an extension of the life of printers because as people need to print, they are taking printers that have not been used for a while and they are buying supplies for them and they are using them. So you could position this as an extension in the life of the printers, which for us, of course is a very positive impact because it means we allow people – to enable people to print without having to invest in them buying a new printer.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Right. But my question is once everyone has a PC at home and a PC at work, after this has passed, any thoughts on the life of the PC after that essential purchase has been made? Do you think those kind of still be the same length or shorter or longer?

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

I think we are still far from that position, Jim. We're far from everybody having access to a PC in each of the countries where we do business, so this is why we are confident that the demand for PCs is going to remain very strong during the next quarter.

At the same time, in some areas, as you are saying, we are seeing there is so much need for PCs, than PCs are being refurbished. Old PCs are being used, which you could position us an extension in the life of the PCs. But we see this as a more short-term effect. What is really driving demand and there is long way to go is the demand for every person to have their own PC.

Operator: Our next question comes from Shannon Cross with Cross Research.

Shannon Cross
Analyst, Cross Research

Thank you very much. I wanted to ask about your graphics in 3D Printing business. I think you mentioned on the call that it was remaining weak, which was one of the impacts to operating margin in the Printing business this quarter. How are you thinking about a rebound there? What are you hearing from customers in terms of their willingness to take capital equipment – or make capital equipment purchases? And perhaps maybe an update on your 3D printing business in general. And then I have a follow-up. Thank you.

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

Sure. So, yes, we shared in the prepared remarks that both our industrial graphics printing and 3D printing overall continue to be impacted negatively by the pandemic. We have seen companies throwing down their investments in capital equipment and in industrial equipment overall and this has impacted both businesses.

What we have seen though is in many of the strategic areas that we have defined for those businesses, significant growth. We are seeing significant growth, for example, in labels and packaging where both in flexible packaging and corrugated packaging, pages or let's say square feet and liters of ink are growing double-digit
year-over-year, which is a great confirmation that this business has a long-term opportunity even if in the short-term it's been negatively impacted by the pandemic.

And I would make similar comments for 3D. The investment in printers has been impacted by companies reducing their investment, but we continue to see the long-term opportunity. And we mentioned in our prepared remarks a very important introduction for us this quarter, because we had said in the past that we see in the future the need to complement our business in printer and supplies with the ownership of some end-to-end applications or high-value applications, and with the launch of our solution to create tooling for molded fiber, we are starting to move in that direction which will allow us to capture more value as customers will be able to do with 3D printing, things that were not possible to do in the past.

Shannon Cross
Analyst, Cross Research

Thank you. Okay. And my second question is with regard to your new Print model, the HP+ brand, which you just started to roll out. I realize it's early, but I'm curious as to how the conversations are going with Staples. Any initial conversations you've had with anyone, what you've seen on hp.com? And I think there's a call with Tuan next week or in a couple of weeks, but I'm curious what you can tell us. Thank you.

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

Yeah. Let me start from that. Since we know this is a topic that where there is a lot of interest, we have organized a special session with Tuan and the team, where they will go in a lot of detail both about the model, the progress we have made and the plans that we have to roll it out across the portfolio and across the different countries during the next year.

But let me give you a few highlights now. First of all, we continue to be very excited about the opportunities that this new business model is going to create. We, as you said, we launched the solution a couple of weeks ago in Staples. We launched three printers, one laser printer and two ink printers, where we are starting to show the incremental value that this brings to loyal customers.

So far, it's early to say what the reaction is, but we are encouraged by the initial responses but we need to wait and see how it goes. But we continue to be very excited about the value this will create, Shannon.

Operator: Our next question comes from David Vogt with UBS.

David Vogt
Analyst, UBS

Thanks, guys. Maybe a little bit of a different topic. Can you give us an update on your structural cost reduction program? I think you mentioned on the call that you had exceeded your first year target of roughly 40% of the gross savings. What does that mean for year two and year three from a timing perspective and a magnitude perspective? And then I have a quick follow-up.

Marie Myers
Acting Chief Financial Officer & Chief Transformation Officer, HP, Inc.

Sure. Thanks and good afternoon. So as you know, that's actually my other role. And I would say, look, we're just very pleased with the progress, and the program is very much on track.
In terms of FY 2020, we’re ahead of schedule and higher actually than the 40% cost reduction plan that we’d originally highlighted. So I just would like to note that the OpEx reductions that you’ve seen this year were both a combination of structural and temporary reductions in areas like travel, events, et cetera, where we’ve been opportunistic because of COVID. So we are committed to staying on track and hitting our plans, and we do expect to achieve at least 75% of the $1.2 billion goal in FY 2021.

David Vogt
Analyst, UBS

Great. That's helpful. And just as a quick follow-up. In terms of your cash flow dynamics balanced by sort of the macro uncertainty that you talked about in your prepared remarks, has there been any change in thought in terms of how you would think about deploying your balance sheet, whether it's changing maybe your target gross leverage ratio, or I know you raised your dividend, or is there any other sort of potential changes in your thought process from a capital allocation perspective? Thank you.

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

Thank you. We continue to remain true to the principle that we outlined in the value plan. Let me remind them to everybody to make sure everybody is on the same page. We increased our target leverage ratio between 1.5 times and 2 times. We have committed to return 100% of our free cash flow over the long-term unless higher return on investment opportunities show up. And this is what we plan to continue to do in the future.

In the short-term, we have increased the amount of shares that we buy every quarter. We bought this quarter $1.3 billion of share. We have announced that we plan to continue to buy at least $1 billion of shares every quarter during the following quarters. We have additionally increased dividend by 10%.

And what we have also decided is, given the uncertainty that we still see in the world, we’re going to remain, for the foreseeable future, in the lower side of the leverage ratio, because we think it's the right thing to be prudent at this time given that many things could evolve in the world in the next two or three quarters.

Operator: Our next question comes from Rod Hall with Goldman Sachs.

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Yeah. Thanks for the chance to ask a question. I wanted to come back to supplies and see, Enrique, if you could talk a little bit – you mentioned that you removed promotions and that's had a positive pricing effect. I wonder if you could talk about how much of a pricing effect that's had on a year-over-year basis. And then I have a follow-up to that.

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

Yeah. We don't disclose the specific details. I can tell you this has been one of the key drivers of the revenue improvement that we saw in Q4. And as I said before, we expect it to continue to happen in Q1 and the early part of next year.

And also, I would say that from a share perspective, if we put aside the geographical differences, we're also meeting our – the share goal that we announced a few months ago. And the combination of usage, higher pricing,
good results and good progress from a share perspective and some of the one-time effects that Marie was talking before are driving the performance that we see in supplies.

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Okay. Thank you. And then my follow-up to that was the other side of that equation, the unit declines in supplies. I wonder if you could talk about whether those were similar to Q3 or were they lower than Q3.

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

I guess you mean the number of pages in Commercial?

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Yes. Yeah.

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

So let me give you some color.

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Not Commercial. Total – yeah, total supplies units, however you want to quantify that.

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

Yeah. So let me give you some color what we have seen. During Q4 – if we look at Q4 compared to Q3 and the number of pages printed, there is an improvement between Q4 and Q3. But if we look at the evolution month-by-month, during the three months of Q4, usage had been fairly stable similar to what we saw at the end of Q3. So improvement quarter-over-quarter, but not much improvement since the end of Q3.

In fact, what we have seen during the last few weeks, and this is more a Q1 comment, with the pandemic growing and the number of cases growing in many countries, we have seen again a slowdown in the number of pages printed in Commercial customers. And this is something that of course is built in our guide and built into the projections we have made.

Operator: And our last question today comes from Matt Cabral with Credit Suisse.

Matthew Cabral
Analyst, Credit Suisse Securities (USA) LLC

Yeah. Thanks for squeezing me in. You mentioned on the PC side that you’re seeing some elevated backlog exiting the quarter. Just wondering if there’s any way to quantify that and talk about how big of a drag that was on the quarter?

And then thinking about the supply constraints from here, just if you could comment on where you’re seeing the biggest bottlenecks and how long you think it will take to reach supply/demand balance going forward?
Sure. Let me take the question, and I'm probably going to sound like a broken record because during the last three calls I have been talking about the limitations that we have been facing because of supply availability. Let me tell you, this quarter, we faced significant – in fact, the backlog that we have at the end of Q4 is big as we have ever had. So you know that the difference between supply and demand is being reduced is actually being increased, but it's all driven by increases of demand.

Demand is really driving, it continues to grow, and we expect that this situation will continue at least through the first half of our fiscal year 2021. So, it's happening and it's here to stay at least for a couple of quarters.

Matthew Cabral
Analyst, Credit Suisse Securities (USA) LLC

Got it. And then sticking on PCs, it seems like there's a lot of moving pieces around margins heading into 2021. Just wondering if you could talk about the puts and takes into Q1 and beyond on the PC side, and how we should think about things like the impact of Chromebooks versus Desktops on mix and the impact of component costs going forward?

Marie Myers
Acting Chief Financial Officer & Chief Transformation Officer, HP, Inc.

Hi, Matt. It's Marie. Maybe I'll take your question. So, let me give you some color around the PS Q1 outlook. So, we do expect those margins to be similar to Q4 back in the 3.5% to 5.5% range, but I think a couple points. First of all, the trends around from work and learn from home are going to continue, and that will definitely continue to drive that mix to Notebooks and particularly into those lower-end ASP products. But we expect that to be somewhat offset by pricing discipline.

And then from a revenue perspective, it'll be slightly below normal seasonality given those supply constraints that we talked about and our backlog will continue to remain elevated.

So, I think, finally, supply chain is normalized, but there are some constraints around panels and CPUs, and this may impact our ability to meet that demand for Notebooks. Thank you.

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

So thank you everybody for joining the call today. Before I wish you a great Thanksgiving for those of you living in the US, let me close with a few thoughts.

What you saw during Q4 was the strength of the portfolio that we have and the fact that we have a leading portfolio both in Consumer and Commercial has really allowed us to deliver these results and to navigate the pandemic in a very strong way during the last quarters.

We have also showed that the team knows how to really execute in this difficult time and they deserve a lot of credit in terms of their ability to identify opportunities, pivot the company, and drive the maximum value that we could from those opportunities. We are very confident about Q1 and the guide that we provided today. Fiscal year 2021 though we have still a lot of uncertainty given where we are in the pandemic, but we know how to navigate the situation and we are confident that we will continue to create value for our shareholders during the next year. Thank you.
Operator: The conference has now concluded. Thank you for attending today’s presentation. You may now disconnect.