27-May-2020

HP, Inc. (HPQ)

Q2 2020 Earnings Call
CORPORATE PARTICIPANTS

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

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

Steven Fieler  
Chief Financial Officer, HP, Inc.

OTHER PARTICIPANTS

Katy L. Huberty  
Analyst, Morgan Stanley

Amit Daryanani  
Analyst, Evercore Group LLC

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

Shannon Cross  
Analyst, Cross Research

Paul Coster  
Analyst, JPMorgan Securities LLC

Jeriel Ong  
Analyst, Deutsche Bank Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to the Second Quarter 2020 HP, Inc. Earnings Conference Call. My name is Eily, and I'll be your conference moderator for today's call. At this time, all participants will be in listen-only mode. We will be facilitating a question-and-answer session towards the end of the conference. [Operator Instructions] As a reminder, this conference is being recorded for replay purposes.

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

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

Good afternoon. I’m Beth Howe, Head of Investor Relations for HP, Inc. And I’d like to welcome you to the fiscal 2020 second quarter earnings conference call. With me today are Enrique Lores, HP’s President and Chief Executive Officer; and Steve Fieler, HP’s Chief Financial Officer.

Before handing the call over to Enrique, let me remind you that this call is being webcast. A replay of the 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 relating to forward-looking statements that involve risks, uncertainties, and assumptions, including the potential impact of the COVID-19
For discussion of some of these risks, uncertainties and assumptions, please refer to HP’s SEC filings.
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 the 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. Let me first say that I hope you and your family are healthy and safe. Our thoughts are with all of those affected by this global pandemic. I especially want to thank all the frontline workers who are showing incredible courage. I speak for all of HP when I say we are grateful for all they are doing.

The world has dramatically changed since our call in February, and we have a lot to cover today. I will start with a brief update on how HP is responding to COVID-19. I will then discuss the near-term impact from the pandemic on our Q2 performance, and I will provide updates on our strategy and our previously announced value plan. Steve will then take you through the details of the quarter and provide updates on our balance sheet, liquidity, and outlook before we open the lines for Q&A.

So let me start with our response to the pandemic. We like to say that tough times are when HP's culture shines brightest, and that's exactly what we have seen in recent months. I am proud of the way our teams have stepped up to support our partners, customers, and communities.

Our top priority has been and will remain the health and safety of our employees. From the start, we quickly pivoted the vast majority of our people to work from home. For those in manufacturing and other critical functions that cannot work remotely, we implemented social distancing along with additional safety and cleaning protocols. And as significantly, we have taken meaningful actions to remain close to our customers and partners.

Specifically, we have implemented a variety of relief initiatives to help them navigate their operational and financial challenges. We believe these investments will further strengthen our relationships and support our value creation strategy over the long term.

But a crisis of this magnitude demands that we do more than simply protect our business. We must also protect the communities we serve. Our teams took immediate actions to deploy our technology and resources to address a range of urgent needs. I will share just a few examples.

HP and our partners have now produced roughly 2.3 million 3D printed parts for face shields, respirators, and other items for distribution to hospitals. And we are now ramping up production of 3D printed nasal swabs with partners to help in the effort for mass testing. Because up to 60% of people currently working from home are...
using personal machines, we made Sure Click security software freely available through September to protect against cyber theft.

And with almost 90% of the world's students out of school, HP and the HP Foundation are donating millions of dollars in technology and grants to enable remote learning. As all our teams have adapted to new routines, I am proud of the way they kept the needs of our customers and our communities front and center.

Turning to our results, there is no doubt that COVID-19 is impacting our business. While some areas performed very well as people shifted to work-from-home, others suffered and we faced supply chain disruptions. Despite these challenges, we delivered non-GAAP earnings per share of $0.51. Revenue was $12.5 billion, down 11%, driven by macroeconomic and supply chain challenges associated with the pandemic.

Let me provide some context on the impacts we are seeing on both the supply and demand side as well as the actions we are taking to mitigate risks. I will start with supply. Both Print and Personal Systems experienced manufacturing and supply chain disruptions during the quarter. As we noted on our February call, manufacturing in China remained shut down after Chinese New Year before beginning to ramp in late February.

Starting in late March, we also experienced disruptions to operations in Southeast Asia and other parts of the world as the pandemic spread. We took swift action to adjust to these developments, and our manufacturing capabilities were largely back to full capacity by early May. We will continue to monitor the situation for any other potential disruptions.

Moving forward, we are evaluating plans to improve the resiliency of our supply chain, including increasing our levels of owned inventory to help mitigate the risk of future outbreaks. On the demand side, there is no question that the lock downs around the world have created new and different demand dynamics in the market. This presents both tailwinds and headwinds across our portfolio, and I want to walk you through what we are seeing.

As people work from home, operate their businesses remotely, and complete the school year online, we are playing an even bigger role in their everyday life. The current environment will have a lasting impact on the way we live and work, and it will further increase the importance of technology. For our business, this presents some attractive near- and long-term opportunities as well some challenges that we will talk about.

In Personal Systems, we saw increased demand as organizations of all types and sizes focused on keeping people connected, productive, and secure. This strong demand, combined with a constrained supply, resulted in an elevated backlog which we expect to work down during Q3.

Customers all around the world have been reminded of the essential role the PC plays, and we're taking action to capitalize on this opportunity. During the pandemic, we have introduced some incredible innovations aligned to customer interest. For example, companies need to rapidly and securely deploy new devices to workers who are either at home or on the frontlines. To meet this need, we launched new enterprise Chromebooks and Mobile Thin Client. We also launched a new range of ZBook by HP mobile workstations and ENVY notebooks that empower creators.

And just this week, we introduced the next generation of Elite PC and ergonomic monitors. We also launched dedicated services to improve employee experiences and help workers connect to the cloud and collaborate with colleagues. And with people spending more time at home, the PC also continues to emerge as a hub of entertainment. Gaming is a best example, and earlier this month, we launched a new lineup of OMEN PCs and displays.
In Printing, we are facing near-term challenges, driven by both supply and demand issues. In Commercial Print, including Office and Graphics, we saw a significant slowdown in late March as offices closed and large events and trade shows were canceled. While we believe that Office and Graphics usage will rebound when businesses fully reopen, we expect that Q3 will be similar to April. And thus, we expect that our financial results will be more negatively impacted in Q3 than Q2.

In Consumer, we saw increased demand for hardware and ink supplies as countries went into lockdown and customers set up home office and school environment. However, we were not able to fulfill all of their orders given the manufacturing disruptions.

On the positive side, we also saw a surge in Instant Ink and now have more than 7 million subscribers accelerating the shift to services that we have been driving. HP's leadership across both Consumer and Commercial Print markets makes us uniquely well positioned to weather the near-term challenges and emerge from the crisis stronger than the competition.

Let me now move to our go-forward strategy and value creation plan. We are continuing to execute the strategy that we outlined at our Securities Analyst Meeting last year, and we remain confident that it will deliver significant value over the long term. As a reminder, our strategy is focused on three key priorities: advancing our leadership in Personal Systems and Print, disrupting industries with our technology and intellectual property, and transforming the way we work across HP to get closer to customers and reduce our costs.

We continue to make progress against our plans and we are rapidly adapting to the new realities of the current environment. In Personal Systems, we are advancing our leadership with a continued focus on high-value categories and cost efficiency. As the PC plays a more integral role in people's lives, we see attractive opportunities to innovate with new hardware, services and solutions, including security and sustainability.

In Print, we are evolving our business model with greater focus on driving more balanced system profitability over time, while also taking significant costs out. We see the opportunity to accelerate the shift towards services. For example, we believe Instant Ink momentum and the broader shift to contractual will continue as work remains more mobile and location agnostic even when the pandemic fades.

In addition, our diverse portfolio across Consumer and Commercial affords us unique opportunities in the changing landscape. We also remain focused on disrupting industries where our innovation and IP give us sustainable competitive advantages. While some of these businesses in Graphics and 3D have been hard hit by the economic slowdown, we believe they will recover post-COVID and they remain significant long-term opportunities for our business.

Supply chain flexibility and resilience will be a priority topic for all companies going forward, and we expect digital manufacturing will be an important part of these discussions. This pandemic has shown the benefits of 3D printing, specifically speed, agility, and localized production. This has led to deeper, more strategic engagement with customers as they evaluate their supply chain and consider more distributed manufacturing models.

As an example, in April, one of our customers, SmileDirect, quickly pivoted during the pandemic from making dental aligners to producing personal protective equipment. To deliver on our priorities, we are executing our transformation program to become a leaner, more digitally enabled company, and the current crisis will actually help accelerate several initiatives. We're making significant progress in these efforts.
Through the first half of the year, we are tracking ahead of our first year target to generate 40% of the total $1.2 billion in gross annualized run rate structural cost savings. We are also taking additional actions to mitigate the short-term headwinds from COVID-19. These start at the top with temporary reductions in executive and board compensation. We're also restricting external hiring and making further short-term reductions in discretionary spending.

As we navigate the current environment, we remain committed to the principles of the value plan we outlined in February. These include the multiple levers we have to drive profitability, our revised leverage target, and our disciplined approach to capital allocation, including returning significant capital to shareholders unless higher ROI opportunities emerge.

As it relates to the value plan targets, we are committed to the long-term goals we have set. However, given the extraordinary and highly dynamic environment in which we are currently operating, the timing to achieve these goals may change. As we have greater visibility on the macro environment, we will be in a better position to provide a long-term financial update. We believe this is the most prudent approach as we act in the best interest of our shareholders and all the stakeholders.

Before I turn the call over to Steve, I want to provide some closing thoughts. HP has always been fueled by innovation, collaboration, and a purpose-driven culture. These are core strengths of our company that position us well in our market and drive our optimism about the future. And although there are challenges right now due to COVID-19, we never lose sight of the big picture.

It is clear that the pandemic shocks can also be a catalyst for change at the intersection of the digital and physical worlds, from the increasing relevance of PCs in people’s lives to the growing interest in 3D and digital manufacturing and the importance of playing across Consumer and Commercial Printing.

We continue to see significant opportunity for HP to drive long-term value creation and we believe our structural advantages, disciplined cost management, and unwavering focus on the customer position us well to navigate the current headwinds while capitalizing on new opportunities across our business.

With that, I will turn the call over to Steve to take you through the financial details.
Non-GAAP operating expenses were $1.6 billion, down $136 million sequentially and $138 million year-over-year. We are seeing tangible structural cost savings achieved through our transformation program as well as the benefits of additional temporary discretionary cost actions taken in response to the current economic headwinds.

Non-GAAP net OI&E expense was $57 million for the quarter. We delivered non-GAAP diluted net earnings per share of $0.51, with a diluted share count of approximately 1.4 billion shares. Non-GAAP diluted net earnings per share excludes a net benefit totaling $23 million related to non-operating retirement-related credits and other tax adjustments, partially offset by amortization of intangible assets and restructuring and other charges. As a result, Q2 GAAP diluted net earnings per share was $0.53.

Before I get into the details by business, let me expand on Enrique’s remarks regarding the supply chain impacts. I’ll cover three points. First, as expected, we experienced manufacturing disruption early in the quarter due to the China factory closures. This impacted both Personal Systems and Print. This created a back-end-loaded supply quarter and a higher Personal Systems backlog entering Q3. For reference, we recorded roughly 50% of our PS revenue in month three, which is historically high.

Second, later in the quarter, we began to see manufacturing disruptions in Southeast Asia which directly impacted our Print business, both hardware and supplies, and we are monitoring any impact to PS component suppliers. Our Print manufacturing capacity returned to normalized levels in early May, so the supply disruption should primarily impact the first part of Q3.

Third, logistics were challenging. We have certain challenges delivering to our end customers in countries with full lockdown, such as India, and in general, our logistics costs were elevated. Altogether, Q2 was a complicated supply chain quarter, but our teams are highly experienced to manage through short-term disruptions.

Turning to segment performance, in Personal Systems, we are proving that the PC is essential. We are pleased with the profit growth of this business despite factory supply constraints that pressured our top line during the quarter. The business benefited from strong demand related to working and learning from home, particularly in Notebooks. Revenue was $8.3 billion, down 7% or 6% in constant currency.

Drilling into the details by customer segment, both Commercial and Consumer revenue were down 7%. By product category, revenue was flat for Notebooks, down 18% for Desktops, and down 23% for Workstations. Personal Systems has been consistently delivering profit growth and improved mix over time. Year-over-year commodity favorability, which was partially offset by higher logistics costs, drove another quarter of exceptionally strong profitability.

Operating margins remained high at 6.6% and operating profit dollars were up 43% year-on-year to $552 million. Personal Systems OP represented 50% of HP’s profit mix for the quarter. We remain confident in our long-term operating margin target of 3.5% to 5.5%.

In Print, we remain uniquely well positioned in the market by being leaders across both Consumer and Commercial Print. However, we are facing near-term challenges driven by both supply and demand issues.

Starting with Q2 demand, we saw a decrease in Commercial Print across our Office and Graphics businesses especially in March and April. This includes a negative impact to both hardware and supplies as businesses have temporarily closed and office workers transitioned to working from home.
Let me illustrate this with some additional detail that we don't typically provide. In Managed Print Services, we saw a roughly 40% monthly decline in pages from February to April, and in Graphics, Indigo impressions went from being up 9% year-over-year in February to down 24% year-on-year in April. On the other hand, in an environment where much of the globe has moved to work-from-home, we saw an increase in overall demand for Consumer inkjet during the quarter.

Looking at the details, Q2 total Print revenue was $4.2 billion, down 19% nominally and 18% in constant currency. Print operating margins were 13.2%, down 280 basis points sequentially, driven by lower hardware and supplies volume, especially in Commercial Print, and a negative impact from supply chain disruptions and higher logistics costs.

That said, despite our Q2 results, we remain confident in our long-term operating margin target of 16% to 18% once workers return to the office and demand improves. By customer segment, Commercial Hardware revenue was down 31% and Consumer Hardware revenue was down 16%. Total hardware units were down 23%, with Commercial units down 25% and Consumer units down 22%.

Second quarter supplies revenue was $2.8 billion, down 15% in constant currency as Office and Graphics printing were significantly impacted by the COVID-19 lockdown orders in the last month-and-a-half of the quarter. In Q3, and until workers return to the office and businesses reopen, we expect supplies revenue to be more pressured than Q2. Overall in Q2, the team remained disciplined in managing channel inventory, keeping Tier 1 channel inventory levels below the ceiling despite the sudden demand declines in the Commercial space.

Let me now turn to our transformation efforts and specifically our cost savings actions and opportunities ahead. A few points. First, we are making good progress on our announced plans and currently tracking ahead of the 40% first-year target we set last quarter as part of our three-year $1.2 billion gross run rate cost reduction plan.

Second, we plan to accelerate cost reductions as much as possible and look for new opportunities including real estate. Third, we are taking prudent steps to reduce discretionary costs as much as possible. While these are more temporary than structural benefits, we believe it's the right thing to do in this environment.

Shifting to cash flow and capital allocation, Q2 cash flow from operations and free cash flow were a negative $0.5 billion and a negative $0.6 billion, respectively. As I signaled last quarter, cash flow was negatively impacted due to the delayed manufacturing timing and back-end-loaded quarter in our business. That said, HP’s businesses are strong cash flow generators over multiple periods, and we maintain a strong balance sheet to meet liquidity needs.

In Q2, the cash conversion cycle was minus 34 days. Timing of procurement and production drove higher AP, inventory, and other assets and liabilities. Accounts receivable increased both due to revenue linearity and also because of the payment extensions we're providing in specific cases to help customers and partners weather the crisis.

We returned $123 million to shareholders through share repurchases and $252 million via cash dividends in Q2. Our share buybacks were limited in the quarter due to the Xerox situation and closed repurchase windows. As Enrique stated, the principles of our value plan remain in place.

This includes how we manage our balance sheet, including the importance of investment grade credit rating and our 1.5 to 2 times gross debt leverage target. In the near term, we will be prudent to focus on managing through
changing dynamics in our business operations as our top priority. Therefore, we expect to be at the lower end of our debt-to-EBITDA range and to hold higher cash on the balance sheet.

Our return of capital principles also remain intact, including our commitment to our robust dividend and share repurchase program. In the near term, we expect to be active in the market and return greater than 100% of our free cash flow in FY 2020. Beyond FY 2020, we remain committed to returning 100% of free cash flow.

In addition, consistent with our previously announced strategy, we intend to pursue a significant enhanced share repurchase program, although the specifics will be determined once market conditions stabilize. We will update you in Q3 on how these plans progress.

Looking ahead, we would like to make the following comments starting with FY 2020. Since the COVID-19 crisis started, we've been stress testing our model and running a number of scenarios based on a range of assumptions. For FY 2020, given the level of uncertainty around the duration of the pandemic, the timing and pace of economic recovery, and the potential impact of a resurgence in cases, there's a much wider range of outcomes for the year. As a result, we will not be providing an outlook for full year 2020.

That being said, we expect our business to generate positive cash flow for the second half of the year. For Q3, we are factoring in our best assumptions at this time, recognizing the situation remains highly dynamic. Specific to Personal Systems assumptions, we expect strong demand given the elevated backlog and surge from working and learning from home. We will closely monitor supply constraints, whether it be CPU or from other select commodity suppliers, and we expect the overall costs from the basket of components and logistics to be higher than we saw in the second quarter.

In Printing, we expect Q3 to be more challenging than Q2 from a demand perspective until office buildings and businesses reopen. This will impact hardware and supplies, especially in Commercial Print. We expect continued positive demand for printing at home. But supply challenges from Southeast Asia will be constraining Consumer Print early in the quarter across hardware and supplies. As a result, we expect Print revenue and margins to be lower in Q3 than Q2 with improvement beginning in Q4 following offices reopening.

Taking all of these considerations into account, we are providing the following outlook. We expect Q3 2020 non-GAAP diluted net earnings per share to be in the range of $0.39 to $0.45 and Q3 2020 GAAP diluted net earnings per share to be in the range of $0.35 to $0.41.

In closing, our strong balance sheet and ample liquidity provide a solid foundation to manage through this uncertain environment, while also providing capacity to capitalize on emerging opportunities which we expect to arrive out of this disruption. We will continue to take the necessary actions to manage through the near-term challenges, while remaining focused on executing our strategy to drive long-term value creation.

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

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

Katy L. Huberty  
Analyst, Morgan Stanley

Thank you. Good afternoon. Enrique, when you rolled out the shift in printer strategy back in October, you said that you would take in market feedback which may cause you to either slow or accelerate the rollout of that strategy and the geographic expansion. How has COVID impacted the pace at which you look to shift the printing strategy, particularly given there is some discussion around more of a structural shift away from the office and towards working in the home? And then I have a follow-up.

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

Sure. Thank you, Katy. So, actually, what we have learned in the last weeks has been very encouraging in terms of the changes or the evolution of the business model that we were driving in Print. As we mentioned during the prepared remarks, we have seen a significant increase in adoption of subscriptions, which is a key part of the evolution. And this means that really supports the rest of the changes that we are going to be driving.

As we announced almost a year now or nine months ago, we will be launching the first products with a new model this fall and we are on track to make that happen. And as we said in February, the feedback we are getting from customers has been very positive, and we have been sharing that now with a significant number of retailers all over the world.

Steven Fieler  
Chief Financial Officer, HP, Inc.

And just to add to that from a contractual perspective, what we've started to hear from customers is, because HP plays so prevalently in both the home and office, and that's not just from a product perspective, but that's from a services perspective, it's from a delivery perspective of how we can uniquely leverage our Managed Print Services offering with our Instant Ink offering to provide that sort of seamless transition from the home to the office with customers' employee base.

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

Yeah, that's a very important comment. We have been having lots of conversations lately with customers on what do they need to do to enable their employees to work from home. They ask for PCs. They ask for accessories and they ask for the ability to be able for their employees to print, and this is a unique advantage that we have.

Katy L. Huberty  
Analyst, Morgan Stanley

Interesting. Thank you for that. Steve, just as a follow-up, can you talk about what the makeup of inventory looked like at the end of the quarter, sort of PCs versus printers and component inventory versus finished goods? Which of those categories drove the increase? And then when should we expect to see inventory fall materially? Thank you.
Steven Fieler  
*Chief Financial Officer, HP, Inc.*

Yeah, I mean, our inventory both in terms of dollars as well as days obviously peaked here in Q2 coming from a lower base in Q1. It was driven heavily by the build in the Personal Systems space. That was really two factors. The largest factor was as expected, the back-end-loaded linearity of the quarter with the China factory shutdown early in the quarter. As we headed to the back half, it just, by math, sort of creates a higher inventory in the back half of the quarter as well as all the in transit. We did pursue some level of strategic buying on the Personal Systems side also in the quarter to set ourselves up for the second half.

Looking forward, I would say that we are anticipating some level of higher inventory than what we traditionally held, not to the levels that we are at today. And that's really more of a function of, in the short term, pursuing some resiliency, particularly around ink or other products that we want to hold a higher balance with. We also did a pretty effective job around channel inventory, and I say that broadly across hardware and supplies. While there's pockets clearly where we had to slow sell-in in the quarter as we reflect in our channel inventory levels, broadly speaking, we remained a lot of disciplined throughout the quarter on CI.

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

Amit Daryanani  
*Analyst, Evercore Group LLC*

Good afternoon, guys. Thanks for taking my questions. I guess, first off, Enrique or Steve, I just want to go back to the capital allocation discussion. If I got this correctly, the commitment is to return over 100% of free cash flow for this year and then 100% for fiscal 2021. But you're going to pause on the outsized buyback program that was part of that $16 billion capital return program. I want to make sure I got that right. And what makes you unpause this? What are the guide posts? What are you going to look for to go back to that outsized buyback program you talked about 90 days ago?

Steven Fieler  
*Chief Financial Officer, HP, Inc.*

Why don't I take that? And I'll repeat a little bit and maybe add maybe a bit more context or color to the prepared remarks. But I think, at the macro level, the principles of the value plan remain in place. And that includes how we manage the balance sheet, our target leverage, the 1.5 to 2 times, the importance of investment grade credit rating.

Also, over time, we do see the opportunity to lower the cash on hand. That being said, in the short term, we think having a higher cash balance is prudent to ensure we can work through any economic cycle. We also see, from a principle perspective, the opportunity to drive free cash flow into the future, and we believe we're undervalued.

So I take all those in consideration, and then specifically in this current COVID-19 situation, there is just a high level of uncertainty. And we believe being prudent with our approach is the most important thing and, therefore, expect to be operating at the lower end of our leverage ratio and then get higher cash on hand, and navigating the business is our top priority.

And then as it relates to the actual return of capital, once we get through the different economic impacts from the pandemic, we're going to update you on the specifics. In the meantime, we do plan to be active, returning at least 100% in this fiscal 2020 year. For 2021 and beyond, we remain committed to the 100% of free cash flow unless there's a better returns-based opportunity.
But I think the fundamental point is when we outlined those principles of how we want to manage the balance sheet, how that would ultimately free up excess cash and how we see the use of that excess cash to return to shareholders all remains, but we really need to manage through this current situation. And clearly, as we look at the months and quarters ahead, we'll be looking at our business and the market in general.

There's things that are in our control, but more importantly, we'll probably be looking at things outside our control at the pace of folks moving back into the office and other social health indicators of making sure we're getting through this situation.

Amit Daryanani  
Analyst, Evercore Group LLC

Perfect. That's really helpful. And if I could just follow up, you guys talked about I think elevated backlog on Personal Systems very specifically, but is there a way think about how big was this backlog and how long does it take to clear up? And I assume this is all around Personal Systems and not supplies, but just any dimensions and timeline to clear the backlog that you guys talked about.

Steven Fieler  
Chief Financial Officer, HP, Inc.

So let me go first. So I won't size a specific backlog. What I'll say – I'll make a couple of points. The first being we've had, from a historical perspective, several quarters of high backlog just given the CPU constraints. What I'd say in the current state, the backlog has been even higher than what we've seen in prior quarters.

Moreover, just from a linearity perspective, and I mentioned this in my prepared remarks, but it's a really important statistic, and that is we have 50% of our revenue in Personal Systems achieved in month three in April. That's historically high levels. And so, as we saw the quarter progress, clearly in the first month and two, we were constrained by supply even though the demand was there. And in month three, when the supply started coming more robustly online, we had a demand to go fill, but it really created a high backlog situation by the end of the quarter, particularly in Notebooks.

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

And what is even more important is not only what is the operational situation, it's what is our confidence about the business. What we have learned during the last weeks are that PCs have become even more essential than they were before for people working from home, for students learning from home, from kids playing from home. And our confidence in the medium and long term for the business has just increased. And whether it is for PCs, for accessories, we clearly see a very strong opportunity in these categories.

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

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

Yes. Thank you. I just wanted to follow up on the PC commentary. So if you're seeing strong demand and you have backlog to fill, should we be expecting PC revenues to be up more than what they typically are in Q3 sequentially? So, sequentially, you're typically up high single digits or double digits. I guess, given all your commentary, that would suggest to me, and given that you have a high level of inventory, that would suggest to
me that you should be able to grow PCs on a sequential basis higher than that high-single-digit seasonal pattern you typically see. Is that a fair interpretation? And if not, why? And I have a follow-up, please.

Steven Fieler  
Chief Financial Officer, HP, Inc.

So when we look at our Q3 expectations around Personal Systems, while I won't specifically guide revenue, I will say that we do see the opportunity to grow above normal sequential. There's a lot of different periods, but I think if you look back in over multiple periods that we see the opportunity to drive upside on a normal sequential growth.

That being said, we continue to monitor to make sure we've got the supply to fulfill that demand, and while all the factories in general have been back up and running, given that much of this demand is coming from Notebooks and given the reliance on various component suppliers in the geographies in which they operate, it's important that we continue to monitor the situation. But from a demand perspective, we're definitely seeing the demand to perform above normal sequential.

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

Okay. And then I just wanted to follow up on the value creation plan. So I get the level of uncertainty. I think what – you've been asked sort two or three times in various forms this question. But let's say that this year is a tough year. Obviously, it's going to be a tough year, and you want to conserve cash. Let's say fiscal 2021 goes back essentially to normal free cash flow generation levels. Can we then assume that, through fiscal 2023, we should expect that you would buy back $13 billion worth of stock, which is what the announced plan, so the timing would get pushed out one year, that you would buy back $13 billion worth of stock?

And I guess, the question would be, why not? You announced this plan when the stock was at $23, it's now $16 and change. And so the proverbial expression of, if you liked it at $23, you must love it at $16 and change. So, is that is essentially what you're saying, things are slowed down, but you're committed to that magnitude over time, it's just going to be pushed out? So we should be thinking that order of magnitude, $13 billion through 2023, let's say, assuming the economy comes back to something close to normal in fiscal 2021?

Steven Fieler  
Chief Financial Officer, HP, Inc.

So this is how we're thinking about it. Again, the principles remain, and from a framework perspective, there's really three drivers, the first of which is the leverage we take on. And while in the current state we expect to be at the lower end, certainly in a more steady state, we have comfort moving up in that range and taking on greater leverage and therefore freeing up cash.

The second is our cash on hand. We finished with $4.1 billion of cash on hand. Again, in a steady state where we don't need to necessarily manage through such severe economic changes in the short term, we can lower the cash on hand, and that would also free up capital.

And then the third is the free cash flow generation. And I guess, to your question, as we begin to stabilize and the market begins to stabilize, we do have confidence in the multiple levers we have to drive cash flow. And as we get more visibility into that free cash flow projection, that clearly provides even further opportunity.

We'll take all those into account to then determine the actual size and deployment of what the enhanced return of capital program could look like, but that's kind of how we're thinking about it.
Operator: Our next question comes from Shannon Cross at Cross Research.

Shannon Cross
Analyst, Cross Research

Thank you very much. I was curious what you've seen and heard from your customers recently as some of the countries in Europe have started to open up and then obviously some of the states both on the Printing and the PC side, and if you've seen some improvement in terms of demand and flow-through. And I have a follow-up. Thank you.

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

Sure. This is something that we are monitoring very, very closely, as you can imagine, Shannon. What we have seen, for example, in China where the recovery started earlier is a fairly steady recovery both of demand, but especially of usage for printing from the office and also in Graphics. 10 weeks after probably the worst week of the pandemic, we are still not at the levels where we used to be, but we continue to see steady progress.

We have also seen some improvement in some of the countries in Europe where the crisis started the earliest. We have seen that Italy, starting to see it in Spain, but are really, let's say, small moves. We think during the next weeks, we start seeing more activity. We will see a similar pattern to what we have seen happening in China.

Shannon Cross
Analyst, Cross Research

Okay. And then I kind of hate to ask this just because of what you went through with Xerox, but I'm curious, the printing industry is obviously under both COVID as well as secular pressures in various places. How are you thinking about consolidation? I mean, is this something that makes sense for you to be involved in, or does it make more sense for share repurchase and perhaps looking at adjacencies or other areas where there's growth like 3D printing? And I'm not indicating you're going to buy a 3D printing company, but just in terms of technology. Thank you.

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

Sure. So at this point, Shannon, our focus is on executing our plan. This is where it was eight weeks ago when before the crisis started and it is even more important now given the overall environment. We had declared and we continue to believe that, in the Office space, consolidation is a value creation activity, but really, we're seeing that now what we need to do is stay focused on our business and continue to drive it forward.

We are also monitoring other M&A opportunities, not only on the core businesses, but also on the growth side that we think, because of the crisis, might be available to us. But again, our focus is on execution of our plan.

Operator: Our next question comes from Paul Coster with JPMorgan.

Paul Coster
Analyst, JPMorgan Securities LLC

Yeah, thanks for taking my question. You're obviously tremendously successful in branding the value creation plan because we want to talk about it. I mean, we're getting our naming conventions right as well. But if I understand this correctly, it's the leverage that is the compromise you've made in the context of what's going on
here. It's not on the expense containment program and the severance and restructuring charges associated with that. Or am I wrong?

Steven Fieler  
Chief Financial Officer, HP, Inc.

Yeah. If we sort of break down the various components of the value plan, there is the sort of return of capital which I think we've discussed already on the call, and, yes, that's to a large extent is on managing through this situation with the right level of leverage and cash on hand.

As it relates to the other components of the value plan and specifically on our ability to drive operating profit dollars and free cash flow into the future, one of the primary mechanisms was the flow-through associated with our transformation program, and that transformation program called out for a $1.2 billion gross cost savings in FY 2022 with $650 million of it dropping to the bottom line.

As we sit here today, we have high confidence in the restructuring and cost take-out program and the structural reductions. In fact, we will continue to look for more opportunities such as real estate and other activities. So we do remain committed to that.

We also will continue to explore other discretionary cost take-outs. Certainly, in the current period, we have taken actions that Enrique highlighted across the company with certain salary reductions and such that we think is the right thing to do. And we're going to accelerate as much of that transformation earlier rather than later given we've got the opportunity to do so with the COVID-19 situation. So the short of it is, is we remain committed to the cost reductions that we have previously committed to.

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

Let me emphasize this point because I think it's important. In terms of the financial goals of the value plan, we stayed fully committed to those, both the profit or the business it will create and also the flow-through that the transformation activities are going to create. There might be some timing impact given the current situation and given that 2020 is going to be a challenging year, but we see both upside, downside. It is for us too early to restate what is the timing of the plan, but we are fully committed to the financial goals that we shared and that we published in February.

Paul Coster  
Analyst, JPMorgan Securities LLC

And maybe this is a technical question. I understand that you do not intend to do the accelerated buyback using debt, but did you get authorization from the board to proceed with that expanded buyback program? And have you the discretion to execute should circumstances magically improve all of a sudden?

Steven Fieler  
Chief Financial Officer, HP, Inc.

So as part of what we announced in February, we also announced that the board did approve an authorization in total of $15 billion of share repurchase for the company. So there is plenty of authorization to pursue an enhanced repurchase program.

Operator: Our final question today comes from Jeriel Ong with Deutsche Bank.
Awesome. Thanks for squeezing me in, guys. So I just had a question on the guidance. It seems like the guidance for the EPS at the midpoint is about 20% lower quarter-on-quarter. Now, I kind of juxtaposed this against your revenue. July, at least in the last four or five years, has averaged about a 4% quarter-on-quarter growth. Kind of seasonally, July is better than April. So I'm just trying to understand, is the guidance for EPS conservative or do you expect revenue as well to be significantly below seasonal and perhaps even down significantly quarter-on-quarter?

Steven Fieler  
Chief Financial Officer, HP, Inc.

Yeah. So why don't I kind of walk through some of the assumptions, I think maybe stating the obvious, but it does remain a highly dynamic situation across both supply and demand. That's why we have a little broader range than we typically would for a quarter. That being said, I think it's important for us to be as transparent around the dynamics that we're seeing. And specific to Q3, the dynamics are different by segment and even different by categories within the segment. So the assumptions are important.

In Personal Systems, I already commented on the expectation for strong demand entering the quarter with high backlog. Therefore, we would expect to see positive sequential, sort of above normal sequential growth as well as good year-over-year growth, assuming that we are supply enabled.

The overall basket of supply chain and logistics cost, we do anticipate to go up quarter-over-quarter driven by logistics cost. And then we are closely monitoring the shift in our unit mix and, in particular, the demand around Notebooks and the work from home and learn from home, including the demand on the Chromebook side.

For Print, and this is really the substance I think of the Q3 guide to your question, we are anticipating that Commercial Print will remain challenged across both the Office and Industrial businesses, and this is a market-wide comment. We saw the negative impact beginning in March and more definitively in April as offices closed.

Unlike Personal Systems where we saw a very back-end-loaded quarter for Print, we saw just a bit over a quarter of the business in month three given the slowdown in demand and our discipline on pulling back on revenue on the Commercial side. As a result, we do expect a larger impact in Q3 across both hardware and supplies, and that's really the driver.

And beyond the COVID-19 situation, we do expect to continue taking cost out of the business, but when you add it all up, what we see today is in between $0.39 to $0.45. Clearly, we're going to be driving the business based upon the respective dynamics that we see, including where we can get supply. But the largest driver of the sequential decline is really that we've got more months in quarter three to deal with from COVID-19 than we did in quarter two.

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

And the key thing is that we see this impact as temporary. So we shared some of this data before. For example, in Managed Print Services, we saw a decline of pages printed of about 40% year-on-year. It's a significant decline as people were not in the office and there were not pages printed in the office. We saw a significant impact in Graphics. We went from growing about 9% in Indigo pages in February to decline more than 20% in April.
Again, these are temporary impacts. As economy will recover, we will go back to a more normal position. But when we look at the impact in Q3, as Steve just said, we expect two months-and-a-half, three months of bad performance in these categories versus about one month.

Jeriel Ong
Analyst, Deutsche Bank Securities, Inc.

Got it. Appreciate that. And as a follow-up, just as kind of the longer-term question, it seems like every quarter, my model just – operating margins on Personal Systems side just keeps marching up. It's six, seven quarters, almost two years now that that's marched up and now above your range. And then conversely, Print, I understand the latest quarter in particular is a little bit different. But, in general, kind of a downward trend now that the mix is 50/50, right, and – when, historically, Personal Systems is probably closer to maybe a third, if not a fourth, of the profit mix between the two segments.

At what point do you think it's structural or do you think that, at some point, you get back to that historical range, whereby Personal Systems is that one-third versus Print, that two-third mix? Or do you think that takes a long time, it's going to happen in short order, or you think we're kind of seeing a new norm here?

Steven Fieler
Chief Financial Officer, HP, Inc.

Well, I guess, we don't manage our business to try to solve for a respective mix. I think we're very pleased with the results from our Personal Systems business and it's sort of, by the end math, that represents half of the company's profits. But to your question, we have been driving very good margins both from a rate, but more importantly, when driving very strong operating profit dollar growth in that business and certainly see the opportunities to continue executing in the higher end of that long-term range, which bodes well for a category where the PC has become even more essential.

On Print, I would say that Q2 and our – embedded in our outlook in Q3 are really temporary challenges in the Print margin structure. We're dealing with larger supplies revenue declines driven by Commercial as well as Commercial Hardware declines. But once the market begins to recover and workers go back to the office, we would anticipate that those margins would normalize back into that 16% to 18%.

And then longer term, as we drive our strategy to drive more profitable customers, to drive a higher mix of contractual, to further penetrate the developing markets with our big tank offerings, these should be margin-accretive opportunities for us in addition to the cost take-outs that we're driving.

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

Let me take now the opportunity to close the session. As always, thank you for joining and thank you for your questions. I wanted to end up by saying that we firmly believe that HP is very well positioned for the future. Most companies are facing challenges right now, but the best companies are those that have not simply weathered the storm, they are taking advantage of the opportunities that we see and transform their company, and this is exactly what HP is going to be doing.

We have many strengths, a very strong balance sheet, a diverse portfolio, very disciplined cost management, and several of the trends that we have seen during the last weeks are going to help us to make our brand even more relevant, even more essential for our customers. Our focus stays in executing our plan and continue to drive value for our customers. Thank you, and stay safe.
Operator: The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.