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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to the third quarter 2020 HP, Inc. earnings conference call. My name is Cole, 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 call 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, everyone, and welcome to HP’s third quarter 2020 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 web page 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. 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. I truly hope you and your families are safe and well.

Our strong Q3 results in the face of unprecedented uncertainty reflect the agility of our team and the strength of our portfolio. Our people have done a tremendous job rapidly adapting to changing market conditions and driving disciplined execution and cost management. As a result, for the quarter, we delivered beyond our expectations on revenue, earnings, and cash flow, and we repurchased $1 billion of shares, well ahead of prior levels.

Importantly, we are navigating the environment well and capitalizing on new opportunities. We are positioning ourselves to meet the evolving needs of our customers from the essential role of the PC in an era of dispersed workforces and classrooms to the rise of subscription-based business models and more personalized solutions.

I consistently tell our team that times like these are when strong companies get stronger. This quarter’s results give me confidence in where we are headed. The strength of our strategy and operational capabilities will enable us to continue leading in both the Print and PC categories.

Today, I’d like to cover three topics with you: a summary on our third quarter performance; the progress we are making against our Advance/Disrupt/Transform strategy and our value plan; and finally, our current expectations for how the pandemic and other market dynamics will impact our business.

In Q3, we delivered revenue of $14.3 billion, flat year on year and up 16% quarter on quarter in constant currency. Non-GAAP EPS was $0.49 and we generated free cash flow of $1.6 billion. Importantly, non-GAAP operating expenses were down over $250 million, driven by our ongoing cost reductions and lower discretionary spend. These are excellent results in the current environment.

We continue to advance our leadership in Personal Systems and Print. In Personal Systems, we delivered growth in revenue, profit, and share, and we delivered record unit shipments in Q3. The PC is more central to daily life than ever, and PC use is up more than 20% since COVID emerged.

We are empowering remote workers and students with the ultimate office and learning experiences at home. This is fueled by a range of innovations that are keeping people connected, collaborative, and secure. For example, in the quarter we launched a broad new lineup of commercial EliteBooks and a new line of ergonomic monitors.
Beyond work, nearly two-thirds of people say the PC is one of the main ways they stay entertained. And this quarter, we expanded our lineup of OMEN and Pavilion Gaming PCs, displays, and accessories.

Turning to Print, the business performed better than we expected. Unit performance improved sequentially as we addressed the supply chain impacts of the factory closures we discussed on the Q2 call. More broadly, we remain uniquely well positioned, given our leadership across both Consumer and Commercial Print, a strength that's a clear advantage in the current environment. The shift to remote work and learning drove an uptick in home printing. We saw an increase of ink usage versus our original target. And we saw strong growth in HP Smart app users, with mobile downloads up 70% year over year. We also launched a new lineup of HP ENVY printers with a family-centric feature set.

We also continued to evolve our business model. We expanded our Instant Ink subscription business, growing subscribers double digits. We expect to surpass 8 million subscribers by the end of the fiscal year. And we are connecting our Instant Ink and Managed Print Service systems to take advantage of the work-from-home trend.

In Q3, we began rolling out the first phase of centralized billing for Commercial employees printing from home. In the coming quarters, we will be expanding these offerings to enable frictionless print from anywhere for customers whose employees are not in the office full time.

Importantly, in Commercial Printing, we did see some improvement as the quarter progressed. In Managed Print Services, July page volume was down roughly 25%, an improvement from April, where we saw a decline of roughly 40%. While there remains much uncertainty about the phasing and pace of recovery, this is an early indication of office usage heading in the right direction.

At the same time, we are making progress against our plans to disrupt industry with our technology, solutions and IP. Across our industrial businesses, we continue to see attractive opportunities to drive medium- to long-term value creation. The benefits of 3D printing and the strength of our ecosystem have been clear throughout the pandemic.

HP and its partners have produced more than 4 million 3D-printed parts for the health care sector. We also introduced a new 3D printing material and established an alliance with Oechsler, one of the industry's largest 3D parts manufacturers.

While Commercial Business segments such as Graphics have been challenged due to business closures, we did see attractive pockets of growth. Labels and Packaging, for example, saw impressions increase 14% year-over-year.

Moving forward, we will continue to capitalize on opportunities to create value for HP and our customers by delivering new end-to-end applications that enable highly personalized products and solutions. And as we advance and disrupt, we are transforming the way we work.

Our focus is to unlock value and become a leaner, more digitally enabled company. We are well ahead of our cost reduction plans for the year and we are making progress against the many initiatives we outlined last fall. We have extended our geographic simplification initiative beyond our sales organization, the supply chain and customer support.

And to adapt our channel program to today's digital realities, we launched a new partner program called Amplify in Q3. The program will enable enhanced data analytics and provide partners with the capability, tools and insights...
required to capitalize on opportunities across the portfolio. Overall, our Q3 results demonstrate the progress we are making against our strategy.

Supporting this strategy is a set of financial principles that we outlined in our value creation plan. These principles include: the multiple levers we have to drive profitability, including our structural cost reduction program; our revised leverage target of 1.5 to 2 times, maintaining an investment-grade credit rating and our commitment to return to shareholders 100% of free cash flow and excess cash over the long term, unless higher return on investment opportunities emerge.

In the third quarter, we increased our share buyback, repurchasing approximately $1 billion in stock. This is the highest level in a single quarter since separation. In the quarters ahead, we expect to maintain similar levels at a minimum. We remain fully committed to the principles of our value plan and are demonstrating concrete progress toward our goals.

This leads me to the next topic, the trends we see in our business. In the Home and Consumer segment, we expect continued strength through at least the end of the year. Even as countries reopen, people will continue to spend more time at home. The commercial market will likely remain dynamic. In Commercial PC, we expect the accelerated mix shift from Desktops to Notebooks to continue, driven by strength in Chromebooks, particularly in Education.

In Office and Commercial Print, as I mentioned earlier, we have seen signs of improvement. We anticipate the reopening of businesses will gradually increase the demand for printing and related services. That said, the phasing and pace of the recovery remains dynamic.

I want to close on HP’s culture. In tough times like this, it matters more than ever, not only a high-performance culture that drives innovation as well as shareholder value, but a purpose-driven culture that creates value for society, and most of all, a culture that unites employees with not only a shared purpose, but also a commitment to doing what is right.

In the face of a global pandemic and a long overdue reckoning with racial inequality, this has never been more important. And I am proud of the way our people and partners are stepping up and taking action to drive systemic change. During a time with so much stress in the world, we have seen our employee engagement scores reach all-time high. The HP culture is a source of strength that is guiding us forward. You will continue to see us take actions to drive a more sustainable, equitable and just future. It is not just the right thing to do, it is good for our shareholders.

In 2019, our Sustainable Impact work helped drive more than $1.6 billion in new sales. Our results this quarter, the commitment of our people and the strength of our culture give me confidence in where we are heading. While we have lots of work to do, we see significant opportunity to drive long-term value creation. Our structural advantages, disciplined cost management and unwavering focus on the customer, position us well to navigate current headwinds and our leadership in both Consumer and Commercial uniquely positions HP to capitalize on opportunities across the business.

With that, I will turn the call over to Steve to take you through the financial details.

Steven Fieler
Chief Financial Officer, HP, Inc.

Thanks, Enrique.
We are pleased with our third quarter results, especially in light of our overall market and macro context. Our performance reflected the company’s multiple profit levers, execution agility and resiliency. Third quarter net revenue was $14.3 billion, down 2% year-on-year or flat in constant currency. As expected, we saw growth in Personal Systems revenue and declines in Print revenue.

Regionally, in constant currency, APJ increased 5%, EMEA increased 2% and Americas declined 4%. Gross margin was 16.7%, down 320 basis points year-on-year. The decline was due to a combination of a higher Personal Systems mix, a higher Consumer mix within Personal Systems and a lower Print rate, driven by volume.

Non-GAAP operating expenses were $1.5 billion, down $274 million year-over-year. The OpEx decline is driven by our ongoing cost reductions program as part of our transformation efforts as well a reduction in discretionary costs.

Non-GAAP net OI&E expense was $42 million for the quarter. We delivered non-GAAP diluted net earnings per share of $0.49, with a diluted share count of approximately 1.4 billion shares. Non-GAAP diluted net earnings per share excludes a net benefit totaling $32 million related to non-operating retirement-related credits and other tax adjustments, partially offset by amortization of intangible assets, debt extinguishment costs and restructuring and other charges. As a result, Q3 GAAP diluted net earnings per share was $0.52.

Turning to segment performance. In Personal Systems, we delivered another strong quarter, growing share, revenue and profit dollars. The business demonstrated its resiliency following the impact of COVID on supply chain issues in fiscal Q2.

In Q3, Personal Systems benefited from strong demand related to working and learning from home, with revenue of $10.4 billion, up 7% or 9% in constant currency. Drilling into the details by customer segment, we saw differing results, with Consumer revenue up 42% while Commercial revenue was down 6%.

By product category, again, the results differed. Revenue was up 30% for Notebooks, down 29% for Desktops, and down 30% for Workstations. The change in mix reflects the strong demand for Notebooks, mainly in Chromebooks from the Educational and Consumer markets respectively, as the shift to working and learning from home continues.

Operating margins remained high at 5.5% and operating profit dollars were up year on year to $570 million, representing 54% of HP’s segment profitability. This is the 11th consecutive quarter of operating profit dollar increase, as the team has effectively navigated headwinds and tailwinds during this time.

In Print, we had anticipated a challenging quarter given the COVID impact on our Commercial business, and the team demonstrated agility and strong execution, meeting or exceeding our expectations. Importantly, HP remains uniquely well positioned in the Print market, by being leaders across both the home and office, with longer-term growth opportunities across our industrial categories. This creates opportunities in this current environment and beyond to address the changing and holistic customer needs by providing innovative, secure, and strong ROI value propositions across geographies and customer segments.

Looking at Q3 demand, as we expected, we saw a decrease in Commercial Print across our Office and Graphics businesses. This includes a negative impact to both hardware and supplies as many businesses remain closed and office workers continued to work from home in many geographies.
On the other hand, in our Home Printing business, we continue to see strong demand coming from work-from-home. As a result, Consumer Hardware revenue grew 7% and units increased 3%, and Commercial Hardware revenue declined 37% and units declined 32%.

Third quarter Supplies revenue was $2.6 billion, down 18% in constant currency, as Office and Graphics printing were significantly impacted by the COVID-19 restrictions. Overall in Q3, the team remained disciplined in managing channel inventory, keeping Tier 1 channel inventory levels below the ceiling.

In total, Q3 Print revenue was $3.9 billion, down 20% nominally and 19% in constant currency. And Print operating margins were 12.2%, which included a full quarter impact of office closures in Commercial Print and the corresponding volume declines. Operating profit dollars were $480 million.

In general, we saw improvement in Commercial Print usage through the course of the quarter as well as our factories back to more normalized levels. Therefore, we remain confident that Q4 operating profit dollars and margin rate will improve sequentially and that as volumes increase, our operating margins will return to our long-term target of 16% to 18% over time.

Let me now turn to our transformation efforts and specifically our cost savings actions and opportunities ahead. Importantly, we are making good progress on our announced plans. We’re currently tracking well ahead of plan in our three-year program to achieve $1.2 billion in gross run rate structural cost reductions. To illustrate, we’ve seen significant operating expense reductions throughout the year, with Q3 non-GAAP OpEx as a percentage of revenue at 10.6%.

As we continue to generate savings, we are at the same time focused on improving effectiveness and speed. As an example, we have seen a positive impact driven across our centralized commercial organization and corresponding supply chain teams, where in recent quarters we improved the speed and flexibility required to navigate the highly dynamic supply and demand changes across the globe.

We are also making investments, especially in digital, which will help our overall customer, partner, and employee experience in the quarters and years to come. During this dynamic environment, we are continuing to reduce discretionary cost as much as possible. While these discretionary reductions can be more temporary than structural, we will continue to focus on driving a lean cost structure to help us navigate.

Shifting to cash flow and capital allocation, Q3 cash flow from operations and free cash flow were strong at $1.7 billion and $1.6 billion respectively, which helped strengthen our revised full-year outlook. In Q3, the cash conversion cycle was minus 30 days. Sequentially, the cash conversion cycle is down four days, driven by more normalized purchasing and sales linearity, including decreases in days payable outstanding, days of inventory, and days sales outstanding.

In Q3, HP raised $3 billion of senior unsecured notes. This is our first corporate debt raise since 2014 and is consistent with our capital structure strategy communicated earlier this year. The proceeds have many benefits, including creating capacity to make disciplined, returns-based capital allocation decisions, including share repurchases, smoothing our debt maturity curve, including retiring approximately $1.6 billion of 2020 and 2021 notes along with short-term commercial paper, and in the near term, during this dynamic period, providing additional balance sheet prudence. These actions incorporate our commitment to an investment-grade rating.

Importantly, we are committed to a robust dividend and share repurchase program. We returned $953 million to shareholders through share repurchases and $251 million via cash dividends in Q3. For reference, these actions
equate to buying back roughly 4% of HP shares in Q3 alone. Year to date, we have returned a total of $2.5 billion, which represents 121% of free cash flow.

Looking forward, in the near term, we expect to continue being active in the market and buy back shares at elevated levels in the range of approximately $1 billion per quarter at minimum. Heading into Q4, keep the following in mind related to our overall financial outlook: We expect macroeconomic conditions to remain uncertain as we continue to monitor the dynamics of the COVID-19 pandemic.

Turning to specific Personal Systems assumptions, we expect continued strong demand in Consumer and Education, with more caution in Commercial, particularly Desktops and Workstations. We expect industry-wide CPU and panel constraints to negatively impact our ability to meet demand, especially for Notebooks, which will constrain top line growth. We expect the cost from the overall basket of commodities to be similar compared to Q3 levels.

From a margin perspective, we would expect Q4 operating margins to be lower compared to Q3, driven by mix changes, but still be in the upper half of our 3.5% to 5.5% long-term operating margin target range. In Printing, we expect Q4 to improve relative to Q3. This includes units, total revenue, Supplies revenue, profit dollars and margin rate. We expect that our supply chain impacts mainly related to the earlier factory closures in Southeast Asia to be largely mitigated.

From a demand perspective, we are still expecting Commercial Print to stay at depressed levels, with positive demand coming from Home Printing. Taking these considerations into account, we are providing the following outlook: We expect Q4 2020 non-GAAP diluted net earnings per share to be in the range of $0.50 to $0.54 and Q4 2020 GAAP diluted net earnings per share to be in the range of $0.32 to $0.36. GAAP EPS includes the cost of restructuring, tax adjustments and onetime defined benefit plan settlement charges.

We expect FY 2020 non-GAAP diluted net earnings per share to be in the range of $2.16 and $2.20 and FY 2020 GAAP diluted net earnings per share to be in the range of $1.83 to $1.87. We expect FY 2020 free cash flow to be in the range of $2.5 billion to $3 billion.

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 [Operator Instructions] And our first question today will come from Matt Cabral with Credit Suisse. Please go ahead.

Matthew Cabral
Analyst, Credit Suisse Securities (USA) LLC

Thank you. I have two questions on PC. So I guess I'll just ask both at the same time. I guess the first one, I'm wondering if there's any way to break out how much of the growth you saw in the quarter was underlying strength versus just the backlog that carried over from April? And just any more incremental commentary about how to think about the demand picture from here? And then the second piece, you guys talked about Chromebooks a couple times in the prepared remarks. Wondering if you could expand a little bit more on what you're seeing there, just how we should think about that relative to your mix? And what that means relative to profitability of traditional PCs going forward?

Steven Fieler
Chief Financial Officer, HP, Inc.

Matt, why don't I take a stab at this? So first, as it relates to demand, I think where I'd start is, we still see very strong demand, particularly in Notebooks, driven heavily by Consumer and Chromebooks. We also saw strong demand in Commercial Notebooks in Q3 and that demand continues to remain strong. I think the way to think about it is, this year has a slightly skewed seasonality, just given the supply chain challenges we saw in Q2, which certainly helped the backlog entering Q3.

We still have a strong backlog on the Notebooks side. But the way to think about it is that our second half of the year should be historically stronger than our first half. Or maybe the other way to think about it is, if we look at our Q4 outlook, our Q4 forecast is roughly in line with what we see a typical Q4 being as a percentage of the total annual revenue mix. As it relates to sort of the margin profile, we are seeing much stronger demand, again, on Consumer and Chromebook and that does have a slightly negative impact on our overall margin rate; that is factored into our Q4 outlook as well.

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

And maybe only one additional comment. As we look at the next quarter, really, the key limitation is not on the demand side; it's actually on the supply chain side, because given the demand that we see in some specific segments, we really need to find – need to continue to find more components, processors and panels to respond to the demand that we see.

Operator: And our next question will come from Krish Sankar with Cowen & Company. Please go ahead.

Krish Sankar
Analyst, Cowen & Co. LLC

Yes. Hi, thanks for taking my question. And congrats on the strong results. The first question I had was on the Print business, do you think the business has broadened or even if it's still tough to say given Commercial is still depressed? And along the same path, are there any tangible milestones you can share as to how we can evaluate the subscription model on the Print business? And then I had a follow-up.
Yes. As I said in my prepared remarks and really as expected or better than expected was our performance in Q3 and our outlook for Q4. And so we are expecting improvement sequentially in our total revenue, in our Supplies revenue, in the total units as well as in the margin dollars and margin rate from Q3 to Q4. So said more directly, yes, we view Q3 as the trough.

And as we look at the recovery, the recovery is really very aligned to the evolution of the pandemic. We have seen the regions where that have – are performing better versus the pandemic have stronger performance, APJ, the regions where still the pandemic is stronger are the ones that still the impact is bigger, like the Americas.

And on the subscription side to, I guess, finish my thought there. I think one of the key things that we keep on focusing on is Instant Ink subscribers. And we started off the year, if I reflect on SAM last year, just about a year ago, we were roughly in the 5 million subscribers. We're now over 7 million and would expect 8 million by the end of this fiscal year, which is I think, a strong indicator of the shift to the subscription model.

And our next question will come from Toni Sacconaghi with Bernstein. Please go ahead.

Yes. Thank you. I was hoping you could just elaborate or clarify a little bit more on capital return. So it sounds like you're saying you're going to look to buy back at least $1 billion in shares per quarter, add your dividend onto that, that's about $1.2 billion in capital return per quarter, $5 billion a year, your cash flow generation is $3 billion per year.

So should we expect this for the next several quarters, meaning three to five more quarters? Are you only commenting on fiscal Q4? And when we think about – you have net debt right now of $1.4 billion, where are you comfortable in absolute terms taking that debt? And will you be looking to raise additional debt to facilitate this buyback? And I have a follow-up, please.

Yes. So from a return of capital perspective, the principles we outlined at the value plan are clearly in place. That does include the significant return of capital. We do continue to believe our stock is undervalued. We are demonstrating our ability to generate strong free cash flow, this year's outlook $2.5 billion to $3 billion. I would say, historically, we've been at the $3.5 billion north level.

I won't comment on future years at this point. But I think what you're seeing is the agility in our portfolio and ability to manage, it's a strong free cash flow generating set of businesses. That ultimately gets to where we are today. And we are kind of at the same time recognizing it's a dynamic economic environment. So we're taking all those factors in considerations and we plan to be active in the market and buy back at elevated levels. It's at the approximately $1 billion per quarter at minimum and we see that over the next few quarters.
Clearly, if things change in the economic environment, we can update you on any change to the return of capital plans from there. In terms of sort of source of capital and your question around net debt, we do have comfort over time of having a higher net debt level and specifically even higher gross debt.

And at the appropriate time, we have the opportunity to potentially access the debt markets again. We are still slightly below our leverage target of 1.5 times to 2 times. And so I think we just need to monitor the situation. And again, at the appropriate time, we do have comfort of going out and accessing more debt.

A.M. Sacconaghi, Jr.
Analyst, Sanford C. Bernstein & Co. LLC

Okay, thank you. And I was wondering if you could just comment on the dynamics in terms of how you’re thinking of sequential growth. So Q3 to Q4, you're typically up as a company about 5% sequentially. Now you could say if you're coming out of an economic recovery, particularly in Printing, we should expect your revenue growth to be above that.

You did seem to suggest, though, that perhaps there could be — could have been some backlog benefit this quarter and could be some supply constraints next quarter. So when we're thinking about the puts and takes relative to normal sequential growth for both Imaging and Printing for Q3 to Q4, should we be thinking about something that is seasonally in line for each of those businesses? And particularly for Printing, why wouldn't we expect it to be better than that, given you're calling for a gradual recovery in folks coming back to work, et cetera? So if you could comment on each of them and the forces at work on sequential growth relative to normal seasonality, that would be helpful. Thank you.

Steven Fieler
Chief Financial Officer, HP, Inc.

I think you’re right to bifurcate between the two segments. And on the Print side, we are expecting above-normal historical sequential growth, driven by the fact that we did see a stronger month three on the Commercial side from a usage perspective than we saw exiting last quarter, and we’re continuing to see strength on the Consumer side. And while there are still some small lingering ripple effects from the supply chain, the factories, again, are generally at normalized levels. So that gives us confidence in an above-normal sequential growth on the Print side.

On the PC side, we're expecting below-normal sequential growth. And that is driven by the two factors, I think, that we responded to in the first question, the first one being we saw sort of the skewed seasonal patterns between Q2 and Q3, and therefore have a much higher Q3 base that we would grow from into Q4.

And then the second factor is, it really starts with the demand, but we're seeing such strong demand on Consumer Notebooks and Chromebooks in particular. We are supply-constrained, and that does impact our growth in Q4. And therefore, again, we would see below-normal sequential growth. You put those two together at the company level, given Personal Systems was 72% of our revenue this past quarter, that at a company level we would anticipate that Q3 to Q4 would have below-normal sequential growth at the company level.

Operator: And our next question will come from Katy Huberty with Morgan Stanley. Please go ahead.

Kathryn Lynn Huberty
Analyst, Morgan Stanley & Co. LLC
Yes, thank you. Can you give us some more color around the page volume recovery that you’re seeing in countries that have reopened or further in the reopening? And then how does that translate to a view around what the printer supplies decline will look like in the fourth quarter? And then I have a follow-up.

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

Sure, let me start with our global number and then I will give more color per region. At the global level, as we shared last quarter, in April we saw a decline on Managed Print Service pages, which is a good proxy, of minus 40%. We have exited July in the minus 25% range. So through the quarter, we have seen significant improvement. We have seen a constant trend, and this is really correlated to the situation versus the pandemic. In many Asian countries where the situation is much more under control, we see volumes close to where they were before the crisis.

In the US and in some of the Americas countries where the impact of the virus is still the strongest, they are still behind, significantly more behind that number, and Europe is someplace in the middle. In the countries where economic activity is almost back to normal, we see usage level not at their previous levels but very close to that. And what I’m talking is really the impact on the Commercial side.

On the Consumer side, on the other side, driven by people working from home, kids learning from home, usage levels are in most cases above our original projections. And this balance on Consumer and Commercial is what really helps us and gives us confidence in what will be the evolution of this business going forward because we can hedge on the Consumer side to really manage whatever impact we see on the Commercial side.

Kathryn Lynn Huberty  
Analyst, Morgan Stanley & Co. LLC

And then as a follow-up, just sticking with Printing, in the context of the shift that you’re seeing from Commercial to Consumer printer hardware sales, what are you doing to improve the historical profitability of those Consumer printer hardware placements as well as the NPV over the life of those printers?

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

Sure, actually let me clarify something. When we look at the business from a system perspective, the Consumer Print business is more profitable for us than the Commercial Print business. Hardware Printers have lower gross margins, but the total business has higher profitability. So this is one of the reasons why this potential rebalancing actually could be even beneficial for us from a margin perspective.

Second, in terms of what are we doing, we are executing the strategy that we shared a few quarters ago in really evolving and shifting or rebalancing the profit between supplies and hardware. And the comment Steve was making about the growth of our Instant Ink business are a clear example of how we are driving that forward. We have seen an acceleration of the deployment of Instant Ink. We think this is a critical part of our strategy. And on the other side, the introduction of the printers with a new business model, we are on track to start having some of these printers in the market by the end of the year.

Operator: And our next question will come from Amit Daryanani with Evercore. Please go ahead.

Amit Daryanani  
Analyst, Evercore Group LLC
Thanks for taking my questions. I have two as well. I guess first off, Steve, I wanted to go back to the capital allocation discussion. How do we think about the duration of how long you were assisting this $1 billion buyback per quarter? And if I heard you guys talk about it, you said it’s going to be at minimum $1 billion per quarter commitment going forward. If I recall, you guys have about a $14 billion authorization that’s out there. So do I think of this momentum to sustain for the next 14 quarters quite literally? And then where does M&A fit into the narrative as well?

Steven Fieler  
Chief Financial Officer, HP, Inc.

So I'll comment on the return of capital and maybe, Enrique, you want to chime in on M&A. The comments they really are, I would say, more in the quarters ahead. Clearly, as the economic situation stabilizes in the timeframe ahead, we certainly can update our view on return of capital at that point in time. But as we see it today, the $1 billion at minimum, again, if I just reflect on Q3, just given where our stock price is, that represented roughly 4% of our shares outstanding. And so anywhere between 3% to 4% of our shares, ability to buy back with that $1 billion at minimum. And so I would say that's really for the quarters to come.

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

Let me complement that because what we are doing is we are taking a prudent approach. We acknowledge that the overall situation is still fluid, and we think it's important to stay with a high level of cash on the balance sheet to make sure we have optionality, depending on how things evolve. But at the same time, given the strength of our progress, we think we can maintain these elevated levels of share buybacks for the next quarter until we have better visibility of what the evolution of the overall environment will be.

Answering now the M&A question, I would say that we are going to remain very disciplined with our capital allocation process. We measure any action that we do on that front against a very rigorous return on capital process. And as we have shared before, any M&A activity we do will have to be aligned with the strategies that we have described, will have to have better ROI than other investments. And clearly, we believe that our shares are undervalued today, and thirdly, to have a clear execution plan. This remains part of our strategy. But again, we will be applying that framework against any opportunity that we will consider.

Amit Daryanani  
Analyst, Evercore Group LLC

Got it, that's really helpful. If I could just follow up quickly on the PC margin commentary for the October quarter, Steve, I think it sounded like it's going to drop down somewhat but be in the upper half of the range. Could you just talk about what are the reasons or what are the levers of headwinds you're having that margins are heading down because I get sales are sub-seasonal, but I assume they're still going to grow. So maybe just what other couple of headwinds you have on operating margin on PCs in October would be helpful.

Steven Fieler  
Chief Financial Officer, HP, Inc.

It's really just mix. And as we're seeing such a large demand in our consumer mix and in particular, in Chromebook mix, it does have a slight downtick on our margin profile. I would say over the long term, all of the actions and opportunities we have in mix remain, driving more displays, accessories, services and premium categories. But certainly, as we evaluate the demand and backlog that we see today, it is more heavily weighted to the Notebook and Consumer Notebook and that does have a downtick on our margin profile. So it's really a mix.
Operator: And our next question will come from Shannon Cross with Cross Research. Please go ahead.

Shannon Cross  
Analyst, Cross Research

Thank you very much. I want to take a step back and think about the Printing business. If we went back to a year ago, which seems like ages ago after everything we’ve all been through. But if you go back, how have the work-from-home, learn-from-home trends changed sort of your outlook on the subsidized, unsubsidized business model you announced, where you might want to be investing in Graphics, the A3 strategy? I’m just kind of curious as to how you’ve looked at what your assets were sort of pre-COVID.

And then how do you think you’re going to be able to leverage them after COVID since you had announced such a sort of large strategy change that obviously, as Enrique, you just said, is going to be rolling out starting at the end of this year. And then I have a follow-up. Thank you.

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

Yes. So the current situation is making that strategy even more important because as the Consumer business becomes more relevant and this is what has happened during the last quarter, and we think will continue to happen during the next few quarters. Really, the importance of the shift into our model where we have profitability, better balance between Hardware and Supplies becomes even more important.

And also, as we shift into subscription models, our ability to maintain high share of HP Original Supplies is higher, which also makes that evolution more important. So as we look at where do we see the business going, clearly, winning in a stronger way in the Consumer side is important for us. As I mentioned before, has higher profitability, and actually, our share is higher, a higher number of pages printed in the office are being printed on HP Printers with HP Supplies. So if pages shift to the home, it's a potentially positive trend for us.

And one of the elements that we have added to the strategy is the need to connect the printers in the office with the printers at home. What we are getting from many of our clients and I think I shared that in the previous call, is that they want to enable their employees to be able to print from home in a secure way and where the company is paying for that.

So what we are doing is connecting our Instant Ink service offering to the Managed Print Service offering. We had already some initiatives that we did during Q3, and we are building the infrastructure to do that in a seamless way during the next quarters. But really what is behind that is really the ability to print anywhere in a secure way with companies paying and funding that for their employees.

Shannon Cross  
Analyst, Cross Research

Okay. And with regard to the A3 strategy, any change there?

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

At this point, no changes there. We continue to have low share in the office. But of course, if the overall office market is lower, eventually, we may end up shifting some of our focus to the Consumer side, if this is the final trend that we see.
Operator: And our next question will come from Ananda Baruah with Loop Capital. Please go ahead.

Ananda Baruah  
Analyst, Loop Capital Markets LLC

Hi, good afternoon. Thanks for taking the questions. Two, if I could Enrique and Steve. Enrique, could you give us a sense of what your Enterprise customers are saying sort of in general about their plans for coming back to the office? You've talked a little bit about that beginning and that's sort of shaking some demand loose, but would love to get context there. And then also, how you guys are thinking about small and medium business exposure as well? And then I have a quick follow-up.

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

Sure. So what we are seeing in general is that many of the big customers are not going to be returning – having their employees return to the office in the foreseeable future. We think this is a consistent trend across different countries. Though there are countries where the situation is better under control and therefore, the number of employees is higher. And actually, similar to what we are doing internally in the company. In many countries where situation is almost normal, we have our employees working back to in the office. In other countries like the US where the impact is still big, most of our employees are still working from home. So this is what we see really happening across the board with many of our large customers.

Ananda Baruah  
Analyst, Loop Capital Markets LLC

That's helpful. Thanks. And then just as a quick follow-up, Steve, on the buyback you did $56 million in this quarter. I think the blend – sorry, the diluted was down just around $20 million. And so is that a matter of timing? Or was there some – as the stock prices dropped, was there some dilutive impact to the dilution – to the diluted shares? How should we think about that? And then also, do you have the ending share count for us as well, quarter ending share count?

Steven Fieler  
Chief Financial Officer, HP, Inc.

Yes. It's likely driven by timing in terms of sort of the accounting treatment on the fully diluted share count is dependent upon the timing and the quarter in which you repurchase those shares. We ended the quarter with 1.4 billion shares. We would definitely see that going down in the quarters to come, given the larger and elevated levels of our buyback program.

Operator: And our final question today will come from Aaron Rakers with Wells Fargo. Please go ahead.

Aaron Rakers  
Analyst, Wells Fargo Securities LLC

Yeah. Thanks for taking the question. I just want to go back to kind of the supply chain and component cost dynamics. Could you help us appreciate or quantify the effect that you're seeing in the current business this last quarter? And any kind of commentary you're expecting on that impact this quarter? And maybe a bit more succinctly, what kind of components are you seeing constraints on because I think we've seen kind of CPU constraints remain a headwind for quite some time. Just curious of what exactly you're seeing there.
Steven Fieler  
Chief Financial Officer, HP, Inc.

Well, I think the sort of the question or issue starts with demand. And again, we are seeing strong demand in particularly categories of our Personal Systems business, i.e., Notebooks and Consumer Notebooks and Chromebooks in particular. That is creating outsized demand. And therefore, when we look at supply, the areas that we see constraints are in panels and in CPUs broadly to fulfill that demand.

Aaron Rakers  
Analyst, Wells Fargo Securities LLC

And on the component cost environment, your – I think some of the component cost dynamics are starting to turn maybe more deflationary. So I'm just curious of why maybe you might not be seeing some of that or are you just being conservative in your expectations the next couple of quarters? Thank you.

Steven Fieler  
Chief Financial Officer, HP, Inc.

We are seeing in certain parts of the basket of overall commodities and components, some deflationary trends. There are other parts that are more inflationary or stable. When we put them all together, including the cost of logistics, we are viewing Q4 to be roughly at similar levels as Q3, again, some up, some down, but overall kind of flat sequentially.

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

Let me close now with some final thoughts. First of all, I wanted to kind of emphasize the fact that, the fact that we have leadership position in both Consumer and Commercial markets for both Personal Systems and Print is a source of strength for us going forward no matter how the current economic situation evolves. And we are really focused on capitalizing on the opportunities that we see ahead of us.

The PC has become essential and as we have discussed today, this is clearly an opportunity for us, but also the fact that we see growth in home printing and home ink subscription services are areas that are going to be helping our plans going forward.

Having said that, we remain very focused on executing our strategy. We are executing what we said we were going to do a few quarters ago and we are very confident in our ability to continue to create value going forward. Thank you for joining us today.

Operator: The conference has now concluded. Thank you for attending today’s presentation. You may now disconnect your lines at this time.