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**HP, Inc.** (HPQ)

Q1 2023 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good day, everyone, and welcome to the First Quarter 2023 HP, Inc. Earnings Conference Call. My name is Lisa, and I will be your conference moderator for today's call. At this time, all participants will be in a 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 Orit Keinan-Nahon, Head of Investor Relations. Please go ahead.

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**Orit Keinan-Nahon**

*VP Finance, Head of Investor Relations, HP, Inc.*

Good afternoon, everyone, and welcome to HP's first quarter 2023 earnings conference call. With me today are Enrique Lores, HP's President and Chief Executive Officer; and Marie Myers, HP's Chief Financial Officer.

Before handing the call over to Enrique, let me remind you that this call is webcast and a replay will be available on our website shortly after the call for approximately one year. We posted the earnings release and 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. 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-Q for the fiscal quarter ended January 31, 2023, 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. In addition, unless otherwise noted, references to HP channel inventory refer to Tier 1 channel inventory. 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.

With that, I'd now like to turn the call over to Enrique.

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## Enrique Lores

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

Thank you, Orit, and thank you to everyone for joining today. Since our Q4 call last November, the macro volatility we described has continued. Our approach remains consistent. We are taking decisive actions to improve our performance, while continuing to invest in long-term growth. By doing what we said we would do, we delivered on our Q1 EPS guidance. And we are reaffirming our full year outlook.

Today, I'm going to focus my comments on three areas: I will begin by summarizing our results and progress against our Future Ready plan. I will then cover our business unit performance. And I will conclude with our outlook before handing the call to Marie.

Starting with our results. Net revenue was \$13.8 billion in the quarter, that's down 19% nominally and 15% in constant currency. This reflects industry-wide headwinds including corporate budget tightening that has started to impact large enterprise demand. Despite this top line pressure, we delivered non-GAAP EPS of \$0.75. This is in line with our previously provided outlook, and it reflects the actions we are taking on cost as well as disciplined execution on pricing and mix.

The Future Ready plan we shared with you last quarter is already having an impact. As a reminder, the plan has two primary objectives. One is to further reduce our cost structure. The second is to continue to assess and optimize our overall portfolio and to develop required operational capabilities to deliver long-term sustainable growth. We are making clear progress in both areas.

In terms of costs, our teams have done an excellent job reducing spend and driving efficiencies. We delivered on our Q1 cost target, and we are on track to deliver at least 40% of our three-year savings by the end of fiscal year 2023. This is allowing us to maintain our investments in long-term growth.

Collectively, our key growth businesses grew double digits in Q1, including Poly. We're investing in a down market, so we can accelerate our growth when the external environment improves. For example, new hybrid work models are fueling demand for peripherals and other collaboration solutions. We will now refer to this part of our business as Hybrid Systems.

Our Hybrid Systems business more than doubled year-over-year, and our Poly integration is going very well. The combined HP and Poly portfolio is creating better experiences for customers and building a strong funnel. Hybrid work is a long-term secular trend driving innovation across our portfolio. We introduced more than 25 new products that earned over 50 innovation awards at CES. This included our new Dragonfly Pro Series, which we

co-engineer with AMD. It reflects how we are building deeper partnerships with our silicon partners to co-create better experiences for customers.

In addition, we launched our new Poly Voyager wireless earbuds, with three mics per earbud they deliver higher quality voice transmission and audio experiences. We are also doubling down on services and subscriptions. There is growing demand for new consumption models that allow us to deliver a better value proposition. And we have created dedicated teams to drive greater focus on these growth opportunities. This supports our strategy to foster lifetime customer relationships and drive recurring revenue.

Last year, we created our Workforce Services & Solutions organization. It is providing customers with an integrated set of offerings and expanding our addressable market. We delivered healthy WSS revenue growth in Q1, and we drove margin expansion by shifting more of our mix to digital services and achieving cost efficiencies. We are excited about the opportunities ahead. Our investments in software, security and AI will enable us to develop new solutions. For example, our HP workstations and data science stack is accelerating machine learning and AI workflows, which is leading to the creation of a new category of high-performance PCs specifically designed for data science and AI applications. And we are partnering closely with NVIDIA on new products and platforms for this growing use case.

And this quarter, we also created a new organization focused on Consumer subscriptions. It's designed to expand upon the success of Instant Ink. Our long-term goal is to ultimately offer the HP portfolio as a subscription.

Let me now touch on our business unit performance, starting with Personal Systems. At the market level, we continue to see soft demand in Consumer and Commercial. We also see pricing pressure given elevated channel inventory across the industry. In addition, corporate budget tightening began to affect large enterprise demand. This is leading to longer sales cycles in our Commercial business.

Against that backdrop, Personal Systems revenue was \$9.2 billion. That's down 24% or 20% in constant currency. Sell out to our customers was higher than sell it to the channel with a corresponding reduction in channel inventory. Our estimate is that end-user demand was stronger than revenue shipments.

PS operating margin was better than expected at 5.4%, and we grew operating profit sequentially. This reflects our actions on cost and a favorable mix shift improving our performance. We accelerated the growth of our Hybrid Systems and PS services businesses, and we remain focused on growing profitable share.

In calendar Q4, we grew shares sequentially in the high-value segments we have prioritized. Our Commercial PC share increased by 2.8 points and our overall PC share grew by 2.5 points as we regained the number one or number two position in all regions.

Turning to Print. Current market conditions are more stable, and we see different dynamics playing out by business. The Consumer Print market continues to see demand softness and pricing pressure. In supplies, the situation in Q1 was better than expected and we continue to see strong adoption of profit upfront and subscription models.

The Commercial Print market is being impacted by macro uncertainty, corporate budget tightening and the uneven pace of return to office. Within Commercial, office printing has seen improvement as the supply situation normalizes.

Taking all this into account, our Q1 Print revenue was \$4.6 billion, that's down 4.5% or 2% in constant currency. We delivered Print operating margin of 18.9%. Operating profit was flat year-over-year in a very tough market. This shows that our strategy is working. Disciplined cost management and favorable pricing in office had a positive impact. Our office hardware revenue grew 13% year-over-year or 5% sequentially, and we gained share in office quarter-over-quarter in calendar Q4.

Although return to office is uneven, the pages per device remain in the range of 80% of pre-COVID expected levels. We also continued to rebalance system profitability. HP+ and Big Tank Printers represented 56% of Printer shipments in Q1 and we gained share sequentially in Big Tank. We now offer the industry's broadest lineup of tanks from the low end of the market to the world's first and only laser tank Printer. We delivered double-digit revenue growth in Instant Ink surpassing 12 million subscribers. And we drove early adoption of our Instant Ink with paper add on.

Industrial graphics and 3D were impacted by macro headwinds, with revenue down year-over-year. We view this as a short-term situation, and we plan to continue investing in these areas to drive long-term growth and value creation. This quarter, we expanded our Jet Fusion lineup and we drove adoption of our Metal Jet solution with key customers such as John Deere and Schneider Electric.

Across our business, sustainable impact remains at the core of our strategy and our leadership on important topics like climate change, human rights and digital equity is building trust in our brand, and it's helping us win new business. It's also driving innovation. Our new all-in-one lineup is a great example. It includes the world's first PC with recycled coffee grounds, which are used in the finish of the device. The enclosure is made with more than 40% post-consumer recycled plastics.

The arm stand uses 75% recycled aluminum, and the stand base uses 100% reclaimed polyester. We have also reduced the product's packaging, so we can ship up to 66% more units per pallet. I am proud we were recently named America's Most Responsible Company by Newsweek for the fourth consecutive year.

Let me turn to capital allocation. As we said last quarter, we plan to maintain our current capital allocation approach, and we are applying the same framework we have used the last few years. We are committed to returning 100% of free cash flow to shareholders over time, unless opportunities with a better return on investment arise, and as long as our gross leverage ratio remains under 2 times EBITDA.

Given the volatility of the market and our growing contractual business, we believe it's important to maintain a healthy balance sheet through prudent financial management. Therefore, we moderated our share repurchase activity in Q1 as planned, while maintaining a leverage ratio within our target range.

Looking ahead, we are not expecting a significant economic recovery during fiscal year 2023. We continue to expect our second half performance to improve relative to the first half driven by our cost-saving measures and as the improved channel inventory levels create a more normalized pricing environment. This is consistent with the view we shared in November.

The PC market in units may regress to pre-COVID levels in the short term, but we expect it will remain at a structurally higher level with more premium and high-value mix. As we said last quarter, we expect the overall Print market to be down low single digits this year. This is mainly driven by the challenging macro environment and slower-than-expected return to the office. And as I said at the top of the call, we are maintaining our full year financial outlook.

To sum up, we are operating in a tough market right now. But we are taking decisive actions as part of our Future Ready plan to improve our performance, and we remain confident in our ability to deliver. By focusing on what we can control, we believe we are well-positioned to navigate near-term volatility. And by maintaining investments in our growth priorities we are strengthening the company for the future. This is what we did in Q1. And it's what you can expect from us moving forward.

Let me now hand the call over to Marie for more details.

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## Marie E Myers

*Chief Financial Officer, HP, Inc.*

Thank you, and good afternoon, everyone. As Enrique said, we continue to focus on what we can control and deliver on the commitments we have made. In Q1, we remain disciplined in rigorously managing our costs and investing strategically while delivering on our outlook. However, our results were impacted by ongoing soft demand. Macroeconomic challenges persisted and corporate budget tightening began to affect large enterprise demand this quarter. We are adapting quickly to the current environment, but see continued opportunity to drive further improvement in our cost structure and operational execution.

Let me give you a closer look at the details. Net revenue was \$13.8 billion in the quarter, down 19% nominally and 15% in constant currency, driven by the declines across each of our regions. In constant currency, Americas declined 16%, EMEA declined 15%, and APJ declined 13%.

Gross margin was 20.3% in the quarter, up 0.4 points year-on-year, primarily due to improved commodities and favorable Print mix, partially offset by competitive pricing, including currency.

Non-GAAP operating expenses were \$1.7 billion or 12.5% of revenues. The decrease in operating expenses was driven primarily by lower variable compensation, rigorous cost management and favorable currency impacts, partially offset by the Poly acquisition. Non-GAAP operating profit was \$1.1 billion, down 28.3%. Non-GAAP net OI&E expense was \$183 million, up primarily due to higher interest expense driven by an increase in both debt outstanding and interest rates.

Non-GAAP diluted net earnings per share decreased \$0.35, or 32% to \$0.75, with a diluted share count of approximately 1 billion shares. Non-GAAP diluted net earnings per share excludes a net expense totaling \$262 million, primarily related to restructuring and other charges, amortization of intangibles, acquisition and divestiture-related charges, debt extinguishment costs and other tax adjustments, partially offset by non-operating retirement-related credits. As a result, Q1 GAAP diluted net earnings per share was \$0.49.

Now let's turn to segment performance. Let me start with pointing out that we have changed our revenue reporting presentation for Personal Systems this quarter. We are now reporting revenue by business capability, Consumer and Commercial versus our previous disclosure by product category, which better aligns with how we think about and manage the business.

The composition of our Consumer and Commercial business capabilities remains consistent with what we have outlined in the past, with the exception of Poly, which is now included in Commercial. Also note that Q1 reflects the first full quarter of Poly results.

In Q1, Personal Systems revenue was \$9.2 billion, down 24% or 20% in constant currency, with FX headwinds as expected. Total units were down 28% with declines in both Consumer and Commercial, driven by soft demand and a tough prior year compare. And while Commercial constituted about 60% of our units, it represented

approximately 70% of our revenue mix for the quarter.

We made solid progress on reducing our channel inventory levels sequentially. However, levels remained elevated for us and across the industry. With that, combined with improved supply availability, pricing competition intensified incrementally in the quarter. Our backlog remains consistent with pre-pandemic levels and still skews favorably towards Commercial higher-value units.

Drilling into the details. Consumer revenue was down 36% and Commercial was down 18%. Lower volumes, FX and increased promotional pricing were again headwinds. Within Commercial, these were partially offset by favorable mix. During calendar Q4, we improved our go-to-market execution and grew our overall market share sequentially.

We also increased our market share in high-value, more profitable segments, including Commercial, desktops and notebooks. Our focus continues to be on driving profitable share growth, especially in the premium segment of our Consumer and Commercial markets.

Personal Systems delivered almost \$500 million of operating profit with operating margins of 5.4%. Our margin declined 2.4 points year-over-year, primarily due to currency headwinds, increased promotional pricing and favorable prior period R&D partner funding. This was partially offset by Poly contributions and lower costs, including variable compensation and commodity costs.

In Print, our results reflect our focus on execution and growing our NPV positive units as well as the strength of our portfolio as we navigate the supply chain environment. In Q1, total Print revenue was \$4.6 billion, down 5% nominally or 2% in constant currency. The decline was driven mostly by lower supplies revenue and currency. Hardware revenue was relatively flat, driven by favorable pricing actions in Commercial, partially offset by unfavorable mix and competitive pricing actions. Industrial Graphics and services revenue declined slightly, reflecting emerging demand weakness in the enterprise space.

Total hardware units increased 2% as component availability and logistics constraints improved sequentially, augmented by better-than-expected China demand. We continued to make solid progress reducing our backlog and are largely back to our pre-pandemic level. By customer segment, Commercial revenue increased 2% or 5% in constant currency, with units down 8%. Consumer revenue was down 3% or up 1% in constant currency with units up 3%.

Consumer Printer demand remained soft in the Americas and EMEA regions, driving incremental promotional activity as supply constraints continued to ease. Commercial hardware demand remained tepid due to both the slow and uneven pace at which the return to office is progressing and enterprise budget tightening.

Supplies revenue was \$2.9 billion, declining 7% nominally and 6% in constant currency. The decline was driven primarily by further normalization in home Printing and a gradual recovery in Commercial. This was partially offset by favorable pricing actions and continued market share gains in ink and toner.

Print operating profit was \$870 million, essentially flat year-on-year and operating margin was 18.9%. Operating margin increased 0.8 points driven by pricing actions and cost improvements, partially offset by promotional pricing, favorable currency and higher commodity costs. The cost improvements were largely due to lower variable comp, expense management and transformation savings.

Now let me turn to our Future Ready efforts. We saw strong progress on our plan in Q1 and are on track to deliver at least 40% of our targeted \$1.4 billion in gross annual run rate structural cost savings by the end of FY 2023.

In Personal Systems, we are targeting structural savings by streamlining our portfolio to better target customer needs. We are increasing leverage in our product and engineering operations by standardizing on fewer platforms to reduce component complexity. We expect these initiatives to reduce duplication and improve our agility and response time to shifting market needs.

We also took actions to optimize costs in our corporate business where we drove significant savings. We continue to optimize and reduce structural costs across our core businesses, particularly in office Print and in our supplies supply chain, including head count reductions.

In addition, we continue to see benefits from our investments to transform our customer support and services organization enhancing our capabilities to provide a more digital enabled customer-centric support experience.

We continue digitizing our customer support engagement assets using AI-based interactive voice response technology. We expect this initiative will help automate our processes to deliver a more seamless and connected support experience.

Lastly, in January, as part of our Future Ready target to reduce employee head count by 4,000 to 6,000, we announced a voluntary early retirement program in the United States. The offer provided eligible employees the opportunity to retire from HP with enhanced benefits. More than 900 participants have opted into the plan with the majority expected to exit during Q2. I continue to be confident in our ability to drive operating cost reductions consistent with our Future Ready goals, enabling investments in our key growth areas.

Now let me move to cash flow and capital allocation. Q1 cash flow from operations was nominally negative and free cash flow was an outflow of \$0.2 billion, in line with our expectations. Our results were impacted by normal seasonality associated with the timing of variable comp payments as well as restructuring charges and lower volumes in Personal Systems.

Additionally, our free cash flow was favorably impacted by the timing of receipts and payments related to our factoring program. This is expected to be net neutral to our full year free cash flow. The cash conversion cycle was minus 22 days in the quarter. This increased 7 days sequentially, primarily due to an increase in strategic buys driving up DOI and an unfavorable business mix impacting both DOI and DPO. While we decreased our inventory \$0.3 billion sequentially in Q1, we have more work to better align our inventory to our business volumes through operational excellence. We will, however, continue to take advantage of economic opportunities like strategic buys, or more sea transit, both of which would result in carrying more inventory.

In Q1, we returned approximately \$360 million to shareholders, including \$100 million in share repurchases and \$259 million in cash dividends. We finished the quarter towards the high end of our target leverage range. Consistent with our disciplined financial management and our strategy to prudently manage our leverage profile and maintain our credit rating in the current challenging environment, we limited our Q1 share repurchases to an amount needed to offset share dilution.

Looking forward to Q2 and the rest of FY 2023, we expect the macro and demand environments will remain challenged and that our customer end markets will remain competitive. We remain focused on what we can control as we navigate these difficult market conditions. We will continue to rigorously manage costs, streamline



operations and improve our performance as the year progresses, while continuing to invest in our growth businesses.

In particular, keep the following in mind related to our Q2 and overall financial outlook. Given the challenging macro environment, we are modeling multiple scenarios based on several assumptions. For FY 2023, we continue to see a wide range of potential outcomes, which are reflected in our outlook ranges I will discuss shortly.

Consistent with the view we shared in November, we are not expecting a significant economic recovery during fiscal 2023. We will continue to focus on driving structural cost savings and efficiencies in our business consistent with the progress we made in Q1 regarding our Future Ready transformation strategy. We expect these cost savings will scale into the back half of the year. Given recent weakness in the US dollar, we now expect currency to be about a three percentage year-over-year headwind for FY 2023.

Regarding OI&E expense, we now expect it will be approximately \$0.7 billion for FY 2023 based on Q1 as a run rate for the year. We continue to expect free cash flow to be in the range of \$3 billion to \$3.5 billion for FY 2023, with the second half of FY 2023 stronger than the first. As a reminder, our FY 2023 free cash flow outlook includes approximately \$400 million of restructuring cash outflows.

Turning to Personal Systems. We now expect the overall PC market unit TAM to decline by a high-teens percent in FY 2023. Specifically, for Q2, we expect Personal Systems revenue will remain under pressure near term and decline sequentially by a high single digit. We expect revenue to improve over the course of the back half of the year, as elevated channel inventory levels are expected to normalize by early fiscal Q3. We expect to continue to drive improved mix shifts toward higher value, more profitable units and services and expect this will help partially offset the headwinds we've discussed today.

We expect Personal Systems margins to be in the lower half of our 5% to 7% long-term range in Q2 as commodities and logistics costs improve in the quarter. But given elevated industry and HP channel inventory levels, pricing continues to be very competitive.

For FY 2023, we expect margins to be solidly in our target range driven by the gradual improvement in PC revenue in the back half of the year and increasing Future Ready transformation savings. In Print, we expect Consumer demand softness will persist and macro uncertainty and corporate budgeting tightening will remain headwinds for Commercial. Disciplined cost management and further normalization in mix as office gradually improves should help to partially offset these trends.

With regard to Print supply chain, similar to what we saw in Q1, we expect component shortages will continue to improve but persist into at least Q2, particularly for office hardware, providing continued support for favorable pricing. Regarding supplies, we expect Q2 revenue in constant currency to decline by a high single digit versus our previous expectation to be down closer to double digits. Given its variability, we do not believe inter-quarter growth is indicative of our long-term supplies growth.

We continue to expect revenue to decline in FY 2023 by low to mid-single digits in constant currency. We now expect Print margins to be above the high end of our 16% to 18% range for Q2, driven by continued hardware constraints. We expect FY 2023 margins also will be above the high end of our range, driven by disciplined pricing, continued progress on rebalancing our system profitability and rigorous cost management, including Future Ready transformation savings.

Taking these considerations into account, we are providing the following outlook for Q2 and fiscal year 2023. We expect second quarter non-GAAP diluted net earnings per share to be in the range of \$0.73 to \$0.83 and second quarter GAAP diluted net earnings per share to be in the range of \$0.40 to \$0.50. We expect FY 2023 non-GAAP diluted net earnings per share to be in the range of \$3.20 to \$3.60 and FY 2023 GAAP diluted net earnings per share to be in the range of \$2.22 to \$2.62.

We continue to make meaningful progress against both our short and long-term strategic priorities in a demanding environment. I am confident we are taking the right actions and making the right decisions to create long-term value for our shareholders.

I'll stop here, so we could open the line for your questions.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. We will now begin the question-and-answer session. [Operator Instructions] We also ask that you please limit yourself to one question and a single follow-up. Our first question comes from Shannon Cross with Credit Suisse.

**Shannon Cross**

*Analyst, Credit Suisse Securities Research*

Q

Thank you very much for taking my question. Can you talk a bit about what's going on in terms of PCs with regard to end demand? And I think you're not alone in saying that second half of 2023 should be better, because inventory levels will normalize.

But I'm wondering, where you're seeing pockets of strength, what you're hearing, how you're thinking about discounting or what features are kind of going to drive an improvement as we get to the second half? And then I have a follow-up. Thanks.

**Enrique Lores**

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

A

Sure. Thank you, Shannon. Let me take the question. So, first of all, something that has not changed this quarter is the weakness that we have seen in the Consumer space that we started to talk a couple of quarters ago.

Something new, though, has been, as we shared in the script, that we have seen weakening demand on the corporate enterprise space, as we have seen especially large companies becoming more conscious about how they use their budget, being slowly hiring people, and this has had an impact in the PC side.

On the positive side, we have seen reductions of inventory, especially that one that addresses Consumer and SMB business, the more transactional side of the business, which reflects that end-user demand has been stronger than shipments.

Our current view is that we will be getting to a normalized channel inventory situation by the end of Q2, early Q3, which means that in the second half, we will not have this headwind, and this is one of the reasons why we are optimistic about the evolution of the PC business during the year. We think that demand will evolve similar to previous seasonality before COVID, and this is one of the reasons why we expect our second half to be stronger than the first half.

**Shannon Cross**

*Analyst, Credit Suisse Securities Research*

Q

Okay. Thank you. And then, Marie, can you talk about working capital and how we should think about it as we go through the year? I understand factoring helped receivables this quarter. I don't know if that's sort of an immediate bounce back or a reversal. And then, just in general, maybe where you think we can end the year in terms of inventory in that, given some of the pre-buys versus ability to work through what you have? Thank you.

**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

Yeah. No. Good afternoon, Shannon. So maybe it's a good time for me just to start out first with how I think about inventory and sort of DOI going forward. I mean, look, candidly, we need to be good at doing both operationally and excellent actually and driving value where we see opportunities.

So as you've seen, we've been very focused on driving up our inventory turns. And when we see economic value, we will pursue strategic buys, right, and look for lower-cost modes of transport. But let me sort of hit up specifically your question around Q1. And what we saw is that inventory turns declined, but not necessarily in line with all our business volumes, and that was really largely a result, Shannon, of the strategic buys that we did in the quarter. So we want to remain open to evaluate those economic opportunities, both for strategic buys and frankly, for lower-cost modes of transport throughout the year.

**Operator:** We'll take our next question from Erik Woodring with Morgan Stanley.

**Erik W. Woodring**

*Analyst, Morgan Stanley & Co. LLC*

Q

Hey, guys, good afternoon. Thank you for taking my question. Marie, maybe this one is for you. You obviously just guided the PC market a little weaker than you communicated three months ago. I think of that as a headwind to cash just given the strong negative cash conversion cycle. At the same time, as you just alluded to, your inventory is still at relatively elevated levels and 1Q free cash flow was negative with a tailwind from factoring. And so I guess my question is really just what gives you confidence in maintaining the full year free cash flow guide? What is it you see in the data? What are some of the specific factors that you think ultimately get you back or get you into that range for the full year? And then I have a follow-up. Thanks.

**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

Good afternoon, Erik. So in terms of how we look at cash for the year, I'd say, first out, our free cash flow for Q1 was absolutely in line with what we expected. And plus, if you look at the earnings outlook that I gave in the guide for the rest of the year. It's absolutely in line with what we guided last quarter. So really, it is the combination of both that give me confidence in our guide of \$3 to \$3.5 billion for the year. A couple of other points of note to pivot off what Enrique said early about seasonality. Now we do expect cash flow to sort of line up with the seasonality comments that Enrique made earlier so we expect it to be better and materially stronger in the second half of the year.

With that said, we do expect cash flow in Q2, therefore, to be roughly in line with Q1. And just remember, in the second half of the year, PS revenue will grow on the top line. And as you know, that PS contributes cash when it grows sequentially because of its negative cash conversion cycle.

Another source of cash just to hit on it. I know Shannon brought up that point a moment ago, another source is obviously continued inventory reductions. And actually this quarter, we did reduce inventory. So both of those, I think, are just really good examples of how we think about cash flow for the year.

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**Erik W. Woodring**

*Analyst, Morgan Stanley & Co. LLC*

Q

Okay. That's really helpful. Thank you. And then maybe my second question is just on Print operating margins. Another really strong quarter that's five consecutive quarters above your 16% to 18% target range. You expect to be above that range for the full year. So are we entering a new paradigm maybe where Print operating margins are going to be above that long-term range? Or are there other factors that you expected to become offsets such that longer-term, we should think about Print operating margins more within that 16% range?

Thanks.

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**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

Yes. Erik, maybe I'll take a shot at that one. So as we've guided, we do expect Print margins to be above the high end of the range going forward, at least for 2023. And really, it's a tale of what you saw in Q1. The Print margins are really driven by, I think, our strategy working. And you see that, I think, in a couple of dimensions, both in terms of rebalancing the profitability between hardware and supplies, also just shifting the business into HP+, Big Tanks. In fact, if you look at the last quarter, more than 50% – 56% of the units shipped were in that HP+ and Big Tank. The other point to note is just the execution. I think if you look at what we did in this last quarter, it's a really good example of where you're seeing the actions both around Future Ready cost cutting, expense management are all showing up, combined with resilient pricing. All those factors are contributing to the robust margins. So, what we saw in Q1, Erik, is really what we expect to see for the rest of the year in Print.

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**Enrique Lores**

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

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Let me add that we are pleased both with the strategic progress we have made and executing the strategies that we defined three years ago, but also taking advantage and getting the benefit from all the work on cost that we did during the last three years and that we are continuing to do now.

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**Operator:** We'll take our next question from Ananda Baruah with Loop Capital.

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**Ananda Baruah**

*Analyst, Loop Capital Markets LLC*

Q

Hey. Thanks, guys for taking the questions. Really appreciate it. I may have missed it Enrique and Marie, but did you mention of the growth business categories what percentage of revenue those are now? And what's the growth profile was for the quarter? And then I have a follow-up as well. Thanks.

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**Enrique Lores**

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

A

Sure. Let me – thank you for the question because this is something that we wanted to clarify. We mentioned briefly on the script, but we wanted to provide more details. So during this quarter, we have made some changes in the definition of the growth categories, because we wanted to align better how we talk about them externally to some of the internal changes we have made.

By growth categories, we really are referring to the six businesses that we think are going to be growing faster than the core business and that are going to have accretive margins compared to core. Something common, they have a common strategic intent, which is really to create more value for customers by focusing on the long-term relationship with those customers. And this is behind the expansion into services, subscriptions and many of these businesses.

During the last quarter, we made two internal changes, one is we created a focused organization to go after Workforce Solutions and Services. And we defined the goal of that team to drive and to grow service driven opportunity. We also have just created a Consumer subscriptions team that will be driving that opportunity across the company starting from the work that we have done on Instant Ink and expanding now and during the next quarter to the rest of the HP portfolio.

And we also decided to align the HyperX business with our gaming PC team. So we have one group that is really responsible for the full experience for gamers. As we went through all these changes, we realign also how we externally will be reporting those especially in the Workforce Solutions & Services, since we are really focused now on service-enabled businesses.

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**Ananda Baruah**

*Analyst, Loop Capital Markets LLC*

Q

And Enrique – I'll keep it here Enrique. Is that to say that you'll no longer be providing us a sense of kind of the old grouping, what the percentage of revenue is and what the growth rates of that old grouping was? And then I have just a quick clarification after that, too. Thanks.

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**Enrique Lores**

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

A

No, we will continue to do that. I will just highlighting the changes because, for example, as we have done that, the overall size of Workforce Solutions is going to be smaller than what it was because we have redesigned, redefined the business. This is what I was highlighting. Every quarter, we will provide visibility as we have done over the last quarters of the growth of the different businesses, you see that on the deck. And every year, we will be reporting the total size as we have done in the past, Ananda.

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**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

And they did grow double digit collectively in the quarter as well, Ananda, just to answer that part of your question.

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**Ananda Baruah**

*Analyst, Loop Capital Markets LLC*

Q

Thanks. And then my quick follow-up is, Enrique, you mentioned in the prepared remarks and you just mentioned a moment ago, shifting the HP portfolio towards subscription. Is that to say the entirety of the HP portfolio, you guys have an eye on moving towards the subscription model? I just want to make sure I understand the context of those remarks.

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**Enrique Lores**

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

A

Yeah. So this is something that we shared already in our Investor Day a couple of years ago, so it's not new. But we see an opportunity to better serve our customers by expanding our subscription business from supplies to eventually other parts of the portfolio. Our long-term direction is to enable a large part of the HP portfolio, but this

is a journey that is going to take multiple quarters. You will see us making progress in the next quarters. We are now including – included paper. We will be including some of our PCs and Printers in the coming quarters. And over time, we will continue to expand the offering.

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**Operator:** We'll take our next question from David Vogt with UBS.

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**David Vogt**

*Analyst, UBS Securities LLC*

Q

Great. Thank you, guys, for taking the question. Maybe this is a question for both Enrique and Marie. When I think about your comments about how the TAM develops in fiscal 2023, if I extrapolate what you've done in the past pre-COVID, it would suggest that by – let's say, by fiscal Q4, your PC segment could be basically flat on a year-over-year basis. Is that the right way to think about the business as it sort of plays out over the next couple of quarters? And then, I have a follow-up.

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**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

Yeah. Maybe I can sort of talk to just the PC outlook and how to think about the guide. So, obviously, a big part of this is, I think what Enrique said earlier around the channel inventory. We do expect that, that channel inventory will get cleaned up through the course of Q2 and then into Q3. And I think Enrique mentioned there some of that pressure that we're seeing in the corporate enterprise space.

And I think this is largely in line with what the industry is assuming. So, at this point, if you look at the midpoint of our guide, we're not expecting any type of macro recovery. But if you sort of group all this together, what we're expecting is, we're going to see better PS revenue in the back half as that channel sort of corrects and cleans up.

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**David Vogt**

*Analyst, UBS Securities LLC*

Q

Okay. And then, maybe, just as a follow-up. If I think about the profitability of PC for the full year, and I kind of extrapolate your comments on revenue in the back half that would suggest that in the second half of the year, just round numbers, quarterly profitability per quarter is going to have to be north of \$0.90 per share.

You're basically flattish with last year. Do you expect – is that the kind of – if I just kind of take the midpoint of your full year guide, is that the kind of leverage you would expect to get as the cost cuts start to flow in more in the July and October quarter from sort of where we are in the April quarter?

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**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

Yeah. So, I'd just say, that ties very much to the comments I made earlier around the channel, but also just combined with the fact that we do expect, I think I said in my prepared remarks, to see ourselves in the lower half of the range in Q2 as we go through that channel correction. Then as we get into the back half, we're going to see the margin rates lift back up to be fully in the range.

And so it's a combination of the channel, plus we've got the impact of our Future Ready efforts. We've already seen some of that impact play out here in Q1. We expect those actions to continue to take a stronger hold throughout the year. So expect to see some of that in the rates as well.

And then I would add another factor, which did help and contribute actually to the margin in Q1, and that was the mix inside the PS business. So remember, we have now a full quarter of Poly in our numbers and that overall mix shift is also a driver and contributing to the overall margin structure as well.

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**Enrique Lores**

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

A

Yeah. Maybe let me add a comment on TAM that I think will help to understand these numbers from Marie. As you were saying from a unit perspective, we expect the TAM of the year to be flattish compared to what it was in 2019, but we expect it to be higher from a revenue perspective because of the change of mix that Marie was explaining. So from a revenue perspective, this has an impact on total TAM, and it will also have an impact on our performance.

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**Operator:** We'll take our next question from Toni Sacconaghi with Bernstein.

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**Toni Sacconaghi**

*Analyst, Sanford C. Bernstein & Co. LLC*

Q

Yes. Thank you. I have two as well. Perhaps you can just give us an update on how much progress and savings were realized in Q1 and specifically, it looks like SG&A went up considerably sequentially, even though revenues were down. And I thought you had two months of Poly last quarter, so there's some incremental Poly, but maybe you can just reconcile what happened with SG&A on a sequential basis? And then how much of the progress towards 40% of the savings do you feel you captured in Q1? And I have a follow-up, please.

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**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

Yeah, Hi. Good afternoon, Toni. It's Marie. So maybe I will just hit up quickly SG&A, what drove that increase sequentially. So primarily, Toni, that was due to the increase in incentive comp and stock comp. So you might recall that Q1 is a normal quarter for our annual equity grants for employees. So that's what you've seen there relative to what drove that increase.

And then with respect to the transformation savings, I would say that we're off to a very strong start. And in fact, these savings contributed to the overall results in the quarter. And you saw that obviously in the evidence in the strength of the margins in both PS and Print. And I would say, look, we are absolutely confident we're on track for the plan for the year. And we're continuing to work that funnel, put more into the funnel. So at this point in time, I'd say we're absolutely committed to delivering at least that \$560 million of gross structural run rate savings by the end of this fiscal year.

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**Enrique Lores**

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

A

And Toni, we have work going across all the areas that we described last quarter from portfolio simplification, removing some elements of the portfolio, simplifying them, making our processes more efficient, using some digital tools, looking for efficiencies across the board. So I think we have a full program across the company driving that, and we are making very good progress.

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**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

And just to reiterate, Toni, they're in both cost of sales and OpEx, so just so [indiscernible] (00:54:14).

**Toni Sacconaghi**

*Analyst, Sanford C. Bernstein & Co. LLC*

Q

Right. Thank you for that. And if I could follow up just on cash flow. So, if I think just really high level, midpoint of your guidance sort of points to about \$3.3 billion in net income. You have \$400 million in restructuring costs that would take you down to \$2.9 billion, adjusting just for that. And then you have a negative mix shift in terms of PCs growing slower than the overall company in all likelihood per your guidance. So that would also hurt free cash flow.

So if I just look at those three structural things, you're actually looking below \$3 billion. So are you – what's the bridge to get to above \$3 billion? Are you counting on meaningful working capital improvements? Because you did condition that you still might do strategic buys or there may be other reasons why perhaps you may not be able to bring down inventory. So perhaps starting with my bridge, you can tell me what's missing and how we can get comfortable with \$3 billion to \$3.5 billion? Thank you.

**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

Sure, Toni. So I think just to reiterate what I did say earlier that both the Q1 numbers and the earnings guide that we gave last quarter, we're absolutely committed to those yet again. So, I think that's just another point to note. But to build off your bridge, the one additional point that you pointed out just around working capital. So we did actually reduce our owned inventory in the quarter from – by about \$300 million. We do intend to continue to have reductions of owned inventory throughout the year. So obviously, we'll be managing those, pending any economic opportunities for strategic buys, as I said earlier.

The other important point to think about is the – we talked about – a bit about this during the call, it's just that second half improvement that we're expecting in Personal Systems revenue. As you know, PS contributes cash when it grows sequentially, and that's because it has that negative cash conversion cycle. So there are just two incremental points to help you sort of model out the cash flow for the year.

**Enrique Lores**

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

A

And then just one clarification. The improvement in inventory that Marie mentioned is net of the strategic buys that we already did in the quarter. So we already did some in Q1.

**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

Correct. Thank you. Yeah. Thank you, Enrique.

**Operator:** We'll take our next question from Sidney Ho with Deutsche Bank.

**Sidney Ho**

*Analyst, Deutsche Bank Securities, Inc.*

Q

Thanks for taking my question. My first question is on the Print side. It does look like the supply is a little better than you expected and you also slightly uptick the guidance for Q2. Just curious what the dynamics that you're seeing there? And do you think the overall business for Print has reached a bottom in Q1, considering supplies are starting to improve and commercial constraints are starting to ease as well. And then I have a follow-up.



**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

Yeah. So maybe I'll just answer your question on supplies. So yes, you're right. We did actually see supplies perform better in Q1 and our guidance that – I think, the guidance we gave in our prepared remarks is that we expect it to decline by only high single digits in Q2. As we sort of think about the year, we do expect supplies revenue growth to be back to what we said at our Analyst Day, so back in that sort of low to mid-single digit.

Some of the sort of drivers of that, firstly, are really the strength that we're seeing around Consumer usage and share trends. Plus I think I commented earlier, just around the pricing resiliency that we're seeing in Print and specifically in supplies. And then finally, I'll just add because I know many of you asked this question, is just around the channel inventory. And if you look across our entire sort of multi-tiered ecosystem, supplies channel inventory is in very good shape.

**Enrique Lores**

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

A

And let me add one comment. And we have said that, when results were below the expectations we had. And I will say now it also when we are above, looking at quarter-on-quarter comparison one year, is really not the best way to look at the health of the business. This is why Marie was saying, we continue to – we maintain the guide that we had for the year for supplies.

Year-on-year comparisons are much better. Small changes one quarter could have a big impact on the quarter-on-quarter compare so really not the right way to look at the health of the business.

**Sidney Ho**

*Analyst, Deutsche Bank Securities, Inc.*

Q

Great. That's helpful. Maybe as a quick follow-up here is that if I look at the full year EPS guide being unchanged, obviously, but there is a lot of different moving parts. Partly, on the positive side, you've got foreign exchange being better, margins seems to be better. It sounds like on the negative side, there's some PC demand weaker than you expected. Just maybe if you can help us bridge the various components that get you back to the original guidance, that would be helpful? Thanks.

**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

Yeah. Look, maybe I'll start out and say, look, the outlook, as you know we've got a pretty broad range there. So it does contemplate multiple scenarios. And obviously, it's prudent. And as always, I think you see that from us. If we can do better, we absolutely will. But a couple of drivers there. I'll just walk you through to kind of get you through the puts and takes on the guide.

First and foremost, we've talked a bit about our cost actions today for Future Ready. We do expect that they're going to continue to yield quite positive results in the back half of the year. And as I said earlier with Toni, we're working that funnel to pull even more savings into FY 2023. So that will be a contributor.

We've talked about channel inventory contribution in terms of Personal Systems. Plus, we did get a chance to hit on today, just the continued improvement in supply chain. I think that's a very important point we didn't get much time to talk about. And then, finally, just remember, at the midpoint, we don't expect a macro, but we're working multiple scenarios. So that's why we've got the range that we have on the guide this time. Thank you.

**Operator:** We'll take our next question from Amit Daryanani with Evercore.

**Lauren Lucas**

*Analyst, Evercore*

Q

Hi. This is Lauren on for Amit. I just wanted to double-click into your views on the PC TAM beyond 2023. What kind of gives you the confidence in a structurally larger PC TAM versus some of the comments that IDC has made and some of the revisions they've made to their long-term forecast? Thanks.

**Enrique Lores**

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

A

I think, there are two big positive trends that I think is worth to highlight. Today, the install base is significantly higher than what it was before. And therefore, at some point, these PC needs to be refreshed. So this gives us a positive tailwind for the business.

Second, from a revenue perspective, as I said before, the way PCs are used today, the applications that are being used for drive better mix, require better configurations. So, when we put both of them together, this gives us the opportunity of them to be bigger.

Additional to that, we see that adjacencies around PCs like the hybrid opportunity in video conferencing systems, cameras that – and we believe the hybrid work is here to stay. That's another incremental opportunity versus what we saw in 2019. And the shift to services, whether its contractual services for businesses or subscriptions for Consumers, also gives us an opportunity of growing the business and growing the TAM.

**Lauren Lucas**

*Analyst, Evercore*

Q

Okay. Thank you.

**Operator:** We'll take our next question from Jim Suva with Citigroup.

**Jim Suva**

*Analyst, Citigroup Global Markets, Inc.*

Q

Thank you and congratulations on the results and outlook. It's very impressive – impressive considered the macro outlook. Question, Enrique, I'm – me and my family are a subscription on Instant Ink, and we love it.

Your comments about shifting to subscriptions. Was that for all options of your various projects? Or was it, you actually think the future sales actually strategically as you think everyone will probably be doing subscriptions only?

The reason why I ask is, I just think there might be kind of the view of potentially both of them helping out. But I just kind of wanted to see, I mean, you said subscriptions for everything, how far down you're kind of thinking about for every single transaction sale? Or is it more of options based upon your clientele?

**Enrique Lores**

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

A

It will be more options depending on the clientele. We know that there are customers that will be willing to buy subscriptions and others that prefer not to. And, of course, we will be offering both.

But since you are a customer already of Instant Ink, let me do a small commercial, you should enroll now to the paper program, because now you can get not only ink, but you can get only paper, which is an addition to the program.

And over time, you will be able to buy the next Printer and other type of services from us. So this is part of the roadmap that we have of expanding the portfolio of subscriptions that we shared in the past and that now is starting to become real.

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**Jim Suva**

*Analyst, Citigroup Global Markets, Inc.*

Q

Well, Enrique, you never know, you can keep a eye on my account. And then a question for Marie. Can you talk about your capital allocation plans? Because now Poly is integrated, it's a full year into your books. How should we be thinking about stock buyback, debt levels, investment, cash levels, where you feel comfortable in uses of capital? Thank you.

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**Marie E Myers**

*Chief Financial Officer, HP, Inc.*

A

Yeah, no worries, and good afternoon, Jim. So, I'd say nothing's changed. We continue to remain the same capital allocation approach that we've used for the last sort of three years or so. But I would say one point, which I think you hear on there, which is we are very focused on keeping our gross leverage under 2. And you would have seen in the quarter that we actually bought back only \$100 million of shares.

So consistent with maintaining our leverage ratio, we don't anticipate buying back shares in Q2, but we do expect that we'll have room for share repurchases in the back half of the year. So I'd just like to kind of close and say, look, we're committed to staying within our target leverage range. For us, maintaining a strong balance sheet and an investment-grade credit rating is just critical to our business, Jim. I don't know, if you have anything you want to add, Enrique?

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**Enrique Lores**

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

A

Yeah. I would like to add like as our leverage ratio will allow us, we continue to believe that buying back shares is a great way to return value to our shareholders, and this is something that we plan to continue to do as we have done in the last years.

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**Enrique Lores**

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

And I think with that, this was the last question. So thank you, everybody, for joining. Thank you for spending time with us today. And maybe let me confirm some of the key messages that we have driven today.

First of all, that even in a challenging environment, we have delivered on the commitments that we made a quarter ago based on the progress we have made in the areas that we can control whether it's costs, price, mix, growing share in profitable categories. We know that this is how we can manage where we need to focus and what we have been doing during the last quarter. And at the same time, we have maintained investment in the growth areas, because we think that our goal continues to be to position HP in a strong way for whenever the economic recovery will happen.

Thank you again for joining us today and looking forward to talking again in a quarter. Thank you.

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**Operator:** And that does conclude today's presentation. Thank you for your participation, and you may now disconnect.