

## HP's Latest Earnings Reflect Challenges in Operations

Martin Reynolds, Carl Claunch, Brian Gammage

Hewlett-Packard (HP) posted respectable revenue growth in fiscal 3Q04, except for its storage and server businesses. The company must correct operational problems and recover growth in its enterprise hardware business.

## NEWS ANALYSIS

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### Event

On 12 August 2004, HP issued preliminary financial results for fiscal 3Q04, ended 31 July 2004. HP said its profit fell short of Wall Street estimates. The company cited weak results in its servers and storage products used by large businesses. It also warned that profit for the fourth fiscal quarter would fall short of analysts' expectations.

### Analysis

HP's fiscal 3Q04 results are more encouraging than they seem. HP's revenue grew 9 percent year over year, buoyed by favorable currency conditions that accounted for 4 percentage points of the increase. With the exception of the company's storage and server businesses, every group turned in respectable revenue growth compared with the same period in 2003. However, the results do expose unexpected challenges that the company must address, such as swiftly correcting operational problems and recovering growth in its enterprise hardware business. Servers and storage revenue declined 9.5 percent — a significant shortfall in the strategic underpinnings of HP's non-printer business. Channel management problems, order processing issues and a softer ending to the quarter than expected contributed to an unexpected decline in overall earnings.

**Server Business:** HP's NonStop and Alpha systems operate in a market that has been declining as companies increasingly favor more open solutions. Both suffered sharper revenue decline than expected, despite the continuing profitability of related support and service contracts. HP will have to replace this lost revenue through other products. In addition, IBM is exerting pressure on HP in the server market. Sun Microsystems also threatens to recover market share. HP has fired and replaced senior executives to address the problem, but it will have to show results during the next two quarters, before changes instituted by any new management could take effect.

**PC Business:** Although HP posted strong revenue growth in PCs, its profits in this area disappointed, given the opportunities presented. Gartner believes that this shortfall relates to channel management and rebate costs in Europe. We believe that rebates also affected the volume server business and encouraged channel partners to use alternative suppliers. Gartner believes that HP has found it difficult to globally align its go-to-market strategy. The European channels are diverse and complex, compounding the problem. Ultimately, HP faces a market share and profit trade-off in its PC business.

**Recommendations:** Remain flexible when dealing with HP, as the expected business management changes will provide buying opportunities and risks.

**Analytical Sources:** Martin Reynolds, Carl Claunch and Brian Gammage, Gartner Research

### Recommended Reading and Related Research

- "Vendor Rating: Hewlett-Packard" — HP continues to settle into its new structure and is making promising efforts to address problems that predate the merger. **By Paul McGuckin, Betsy Burton, Martin Reynolds, Carl Claunch and Andrew Butler**
- "Seven Steps to Consider in Server Platform Migration" — Migrating to new server platforms takes lots of time and money. The rewards may be big, but if you don't use due diligence, your migration could fall short of expectations. **By Mike Chuba**

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