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Quarterly Financial Results Position HP for Growth in 2010

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HP's financial results reflect a troubled economy but also indicate that the bottom of the downturn is likely behind us. IT buyers should use downturn activity constraints to evaluate strategic opportunities with vendors.

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NEWS ANALYSIS

Event

On 18 August 2009, HP announced financial results for its third fiscal quarter ended 31 July 2009, with net revenue of $27.5 billion, down 2% from a year earlier and up 4% when adjusted for the effects of currency.

Analysis

HP's financial results reflect a troubled economy but also indicate that the bottom of the downturn is likely behind us. HP's focus on operations is paying off — profits and cash look good for a downturn, and the company is aggressively shaping its workforce and product lines. The true measure of the restructuring will come when business buyers again look for strategic technologies from suppliers.

Currency is becoming less of an issue as the U.S. dollar weakens, with HP reporting just a 2% drop in dollar revenue from 2008. However, the overall results still reflect the dismal state of the global economy. The inclusion of July provides an opportunity to see any signs of potential recovery, but there are none visible.

The PC business grew units 2%, but revenues dropped 18%, reflecting the weak state of the business market and the ongoing slide in PC prices. This decline may well be structural, presaging an increasingly challenging PC market. When business buyers return, results will likely improve, however HP will have to further develop its brand and maintain its supply chain effectiveness to maintain global growth and defend against offshore competition.

Printers generated the usual significant cash flow but, unlike the other segments, showed a big 5% sequential decline in revenue. HP attributes the difference to channel inventory adjustments and claims that page volumes appear stable. However, the downturn could drive print users to develop new paperless habits, and this trend bears watching as markets start to recover.

The systems business, with its dependence on business purchases, turned in an unsurprisingly poor performance in line with the market. Blades did the best with a 14% drop in revenue, x86 servers came in the middle with a 21% decline and Itanium systems dropped 30%. We look forward to a refreshing of Itanium systems in 2010 when new architectural features will allow HP to bring some energy to the product line. The technology's timing benefits from the business buying slowdown, as HP will offer compelling new products once businesses look to spend. On the other hand, HP may face some stiff competition from an Oracle-owned Sun Microsystems in this market. Software, with its strong link to operational management, declined in a similar fashion.

The services business slid slightly against Q2 results. Approximating EDS revenue to $5.6 billion using EDS' Q208 report suggests a total revenue of $10 billion as a fair comparison for the combined revenue of EDS and HP a year ago (HP does not include pre-acquisition EDS revenue in its comparisons). This method suggests a dollar decline of about 15% in combined HP and EDS services revenue, most of which is likely driven by currency fluctuations.

RECOMMENDATIONS

IT buyers:

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- Use downturn activity constraints to evaluate strategic opportunities with vendors. The change in HP's structure and objectives is not unique. All vendors are retrenching and planning long-term strategies that link to cloud computing, scale and business solutions.

RECOMMENDED READING

- "SWOT: HP, Servers, Worldwide" — HP has significant strength in its x86 market leadership, the installed base and its strong, broad partner base. **By Adrian O'Connell**
- "It's Time to Prepare for a Return to Business Growth" — Many economists predict that marginal growth will occur in 2010, and clients should prepare for it. **By Ken McGee and Mark Raskino**

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