

Hewlett-Packard (HPQ)

FORECAST INCREASE

Rating **NEUTRAL***
Price (23 May 12, US\$) 21.08
Target price (US\$) 30.00[†]
52-week price range 37.47 - 21.08
Market cap. (US\$ m) 41,682.39

*Stock ratings are relative to the relevant country benchmark.
[†]Target price is for 12 months.

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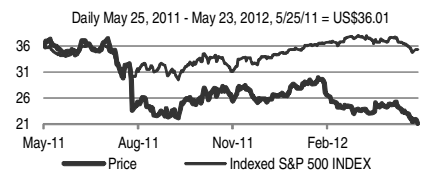
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Promising set of results

- **A promising set of results...** This quarter, execution was strong across the board (both FCF and profitability) with revenue of \$30.7bn and EPS of \$0.98 (above our & Street EPS estimates of \$0.90/\$0.91). Notably, revenue declines slowed to -3% yoy, margins improved in Services for the first time in 6 quarters, printing margins up-ticked for the first time in 6 quarters and FCF almost tripled to \$1.5bn. We raise our FY12/13 EPS estimates by 2%/2% to \$4.08/\$4.41. We retain our Neutral rating given lack of visibility on revenue growth.
- **Restructuring welcomed and long overdue; reinvestments look significant.** The company announced a streamlining of its operations and expect a 8% (~27,000) reduction in headcount. This should deliver \$3-3.5bn of annualized cost savings long term. We would caution that a significant amount of these savings will be reinvested over the next 2-3 years. However, even 30% retention would deliver incremental EPS of \$0.40 over the long term. Given a lack details on the savings retention, we have erred on the side of caution for FY13 pending further details.
- **Three reasons not to upgrade.** Execution has improved and on 5x our FY13 estimates, the stock is inexpensive but several risks remain. First, we believe Services is in multi-year transition, hence we are wary of extrapolating from recent OM and forecast 9% and 10% for 2012/2013, especially with cloud investments being potentially capex heavy. Second, we see secular issues facing the HP PC business in terms of tablet of cannibalization. Third, we believe that weak end market demand (in IPG, ESSN, and PSG) and restructuring will inevitably impact the revenue profile, meaning top line growth could remain challenged. Currently, we forecast -1.5%/1.3% revenue growth in 2012/2013.
- **Valuation.** Shares are inexpensive, but given fundamentals, a low multiple is warranted. We apply a 7x multiple to our CY12 EPS to arrive at a TP of \$30 and continue to prefer Apple and EMC in IT Hardware.

Share price performance



On 05/23/12 the S&P 500 INDEX closed at 1318.86

Quarterly EPS	Q1	Q2	Q3	Q4
2010A	1.07	1.09	1.08	1.33
2011A	1.36	1.24	1.10	1.17
2012E	0.92	0.98	0.97	1.21

Financial and valuation metrics

Year	10/10A	10/11A	10/12E	10/13E
EPS - (Excl. ESO) (US\$)	4.57	4.89	4.08	4.41
EPS (CS adj.) (US\$)	4.57	4.89	4.08	4.41
Prev. EPS (CS adj.) (US\$)	—	—	4.00	4.31
P/E (CS adj., x)	4.6	4.3	5.2	4.8
P/E rel. (CS adj., %)	—	31.3	40.9	42.5
Revenue (US\$ m)	126,033.0	127,387.0	125,539.5	127,149.8
EBITDA (US\$ m)	19,220.0	18,735.0	16,620.1	17,531.2
Net debt (US\$ m)	11,370	22,591	18,384	10,699
OCFPS (US\$)	5.02	5.95	4.84	6.42
P/OCF (x)	8.4	4.5	4.4	3.3
Number of shares (m)	1,977.34	Price/sales(x)		0.33
BV/share (Next Qtr., US\$)	19.8	P/BVPS (x)		1.0
Net debt (Next Qtr., US\$ m)	22,787.0	Dividend (Next Qtr., US\$)		0.12
Dividend yield (%)	0.58			

Source: Company data, Credit Suisse estimates.

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Financial Model

Exhibit 1: HP Income Statement

in millions, unless otherwise stated

	FY 2009	FY 2010	FY 2011	FY 2012E	FY 2013E
Revenues	114,552	126,033	127,387	125,540	127,150
% change yoy	-3.2%	10.0%	1.1%	-1.5%	1.3%
COGS (incl. options)	87,489	95,852	96,870	96,057	96,083
Options expense (COGS)	178	169	132	136	136
Gross profit (incl. options)	27,063	30,181	30,517	29,415	30,931
Gross margin (%)	23.6%	23.9%	24.0%	23.4%	24.3%
SG&A (incl. options)	11,648	12,822	13,512	14,272	14,672
% of sales	10.2%	10.2%	10.6%	11.4%	11.5%
Options expense (SG&A)	374	443	460	460	460
R&D (incl. options)	2,819	2,959	3,254	3,703	3,814
% of sales	2.5%	2.3%	2.6%	3.0%	3.0%
Options expense (R&D)	57	55	60	60	60
Amortization	1,571	1,484	1,607	2,400	1,500
Restructuring and others	889	1,437	2,467	1,400	900
Total opex (ex. amort/ restructuring)	14,467	15,781	16,766	17,975	18,486
% of sales	12.6%	12.5%	13.2%	14.3%	14.5%
Operating income (PF, incl. options)	12,596	14,400	13,751	11,440	12,445
Operating margin (%) (PF)	11.0%	11.4%	10.8%	9.1%	9.8%
Operating income (GAAP, incl. options)	10,136	11,479	9,677	7,640	10,045
Operating margin (%) (GAAP)	8.8%	9.1%	7.6%	6.1%	7.9%
Restructuring and others	0	0	276	(36)	0
Interest income (expense)	(721)	(505)	(695)	(1,000)	(1,200)
Gains (losses) on investments	0	0	0	0	0
Pretax income (incl. options)	11,875	13,895	13,332	10,404	11,245
Pretax margin (%)	10.4%	11.0%	10.5%	8.3%	8.8%
Provision for taxes	1,755	2,213	1,908	1,375	1,946
Adjustments for taxes	754	816	1,045	914	528
Taxes (PF, incl. options)	2,509	3,029	2,953	2,289	2,474
Tax rate (%)	21.1%	21.8%	22.1%	22.0%	22.0%
Tax benefit from options	199	215	200	200	200
Net income (PF, incl. options)	9,366	10,866	10,379	8,115	8,771
Net margin (%) (PF)	8.2%	8.6%	8.1%	6.5%	6.9%
Net income (GAAP, incl. options)	7,660	8,761	6,305	4,315	6,371
Net margin (%) (GAAP)	6.7%	7.0%	4.9%	3.4%	5.0%
Earnings per share (pro forma)	\$4.00	\$4.76	\$5.10	\$4.31	\$4.64
Options expense per share	(\$0.17)	(\$0.19)	(\$0.21)	(\$0.23)	(\$0.23)
PF EPS (incl. options)	\$3.83	\$4.57	\$4.89	\$4.08	\$4.41
GAAP EPS (incl. options)	\$3.14	\$3.69	\$2.97	\$2.17	\$3.21
Diluted shares outstanding	2,443	2,377	2,124	1,990	1,987
Basic shares outstanding	2,388	2,319	2,094	1,980	1,979
Dividends per share	\$0.32	\$0.32	\$0.40	\$0.50	\$0.51

Source: Company data, Credit Suisse estimates

Companies Mentioned (Price as of 23 May 12)

Apple Inc. (AAPL, \$570.56, OUTPERFORM, TP \$750.00)

EMC Corp. (EMC, \$25.46, OUTPERFORM, TP \$35.00)

Hewlett-Packard (HPQ, \$21.08, NEUTRAL, TP \$30.00)

Disclosure Appendix

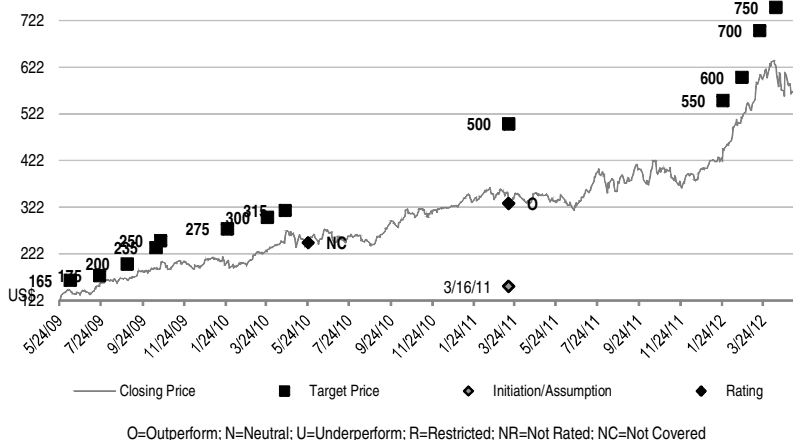
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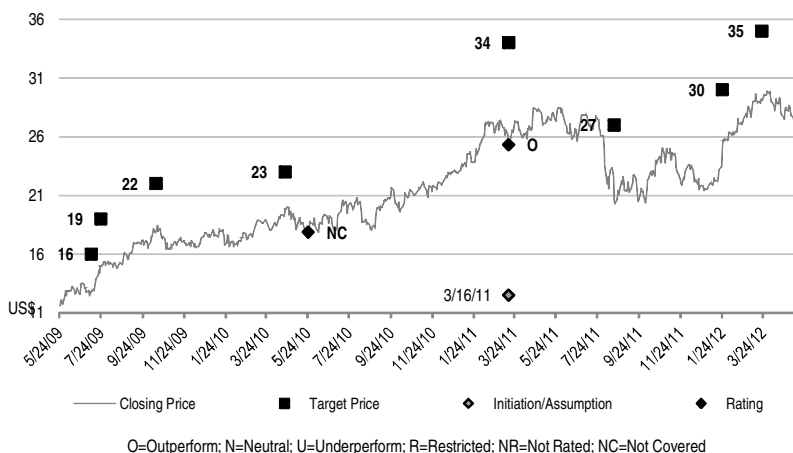
3-Year Price, Target Price and Rating Change History Chart for AAPL

AAPL Date	Closing Price (US\$)	Target Price (US\$)	Initiation/ Rating	Assumption
6/9/09	142.72	165		
7/22/09	156.74	175		
9/1/09	165.298	200		
10/13/09	190.02	235		
10/20/09	198.76	250		
1/26/10	205.94	275		
3/26/10	230.9	300		
4/21/10	259.22	315		
5/25/10	245.22		NC	
3/16/11	329.76	500	O	X
1/25/12	446.66	550		
2/22/12	513.04	600		
3/19/12	601.1	700		
4/12/12	622.56	750		

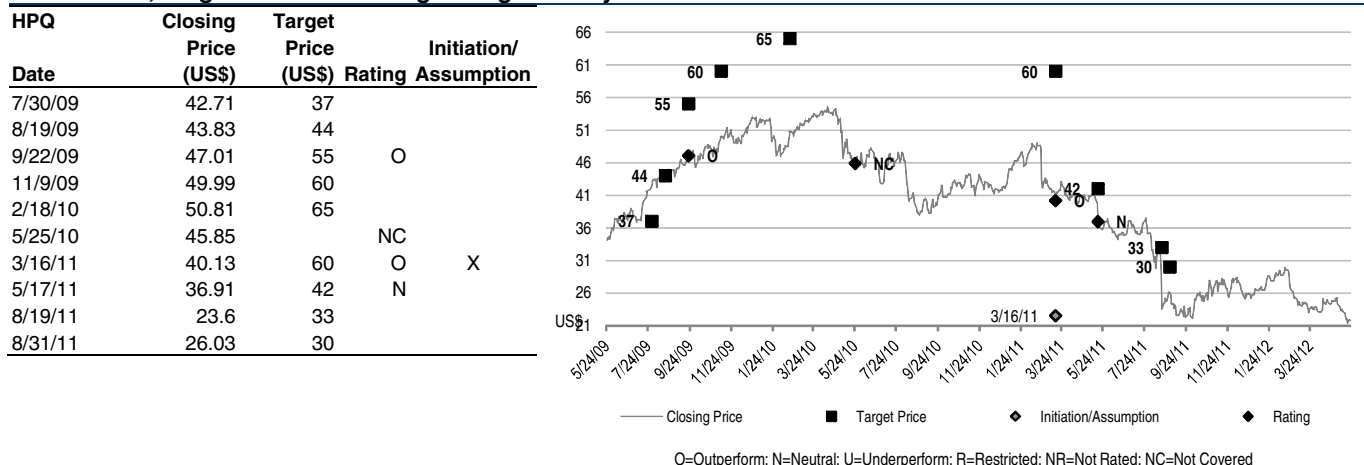


3-Year Price, Target Price and Rating Change History Chart for EMC

EMC Date	Closing Price (US\$)	Target Price (US\$)	Initiation/ Rating	Assumption
7/10/09	12.8	16		
7/24/09	14.95	19		
10/13/09	17.92	22		
4/21/10	19.85	23		
5/25/10	17.85		NC	
3/16/11	25.31	34	O	X
8/18/11	20.59	27		
1/24/12	25.14	30		
3/22/12	29.13	35		



3-Year Price, Target Price and Rating Change History Chart for HPQ



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Restricted	2%	

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Price Target: (12 months) for (AAPL)

Method: Our target price for Apple is \$750. We calculate this by applying a 12x multiple to our CY2013 taxed operating EPS per share and add back onshore cash per share. Our multiple is slightly discounted to the market, in-line with the stock's historical performance.

Risks: Risks to achievement of our \$750 target price for Apple Inc. include competitive pressures from global consumer electronics companies, failure to launch innovative products, loss of key executive managers, failure to maintain key media distribution for iTunes, and regulatory risk

Price Target: (12 months) for (EMC)

Method: Our \$35 TP is based on a 16x multiple applied to 2013 EPS estimate (13x ex-cash), in-line with the 5-year historical average. We believe this is warranted, given steady growth and impressive FCF dynamics (consistent FCF conversion of 175% over the last 5 years).

Risks: Risks to achievement of our \$35 target price for EMC Corp. include increased competitive pressures from storage vendors and server OEMs, development of disruptive storage technologies, decrease in Information Technology spending as a result of macroeconomic downturn, as well as merger and acquisition integration risks as EMC remains acquisitive.

Price Target: (12 months) for (HPQ)

Method: Our target price for Hewlett-Packard Co. is based on 7 times multiple applied to our 2013 EPS of \$4.41 resulting in a fair value estimate of \$30. Given the limited growth outlook in servers, PCs, and within HP's Services group we believe it should trade at a discount to peers such as Dell and IBM.

Risks: Risks to achievement of our \$30 target price for Hewlett-Packard Co. include declining Information Technology spending as a result of macroeconomic downturn, increased competitive risks within client (PC and printers), server, storage, and services, as well as merger and acquisition integration risks as HPQ remains acquisitive.

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