Hewlett Packard (HPE)

$9.38 (As of 04/02/20)

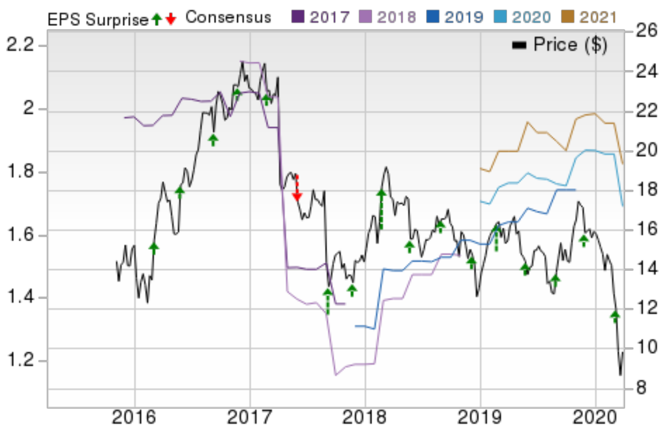
Price Target (6-12 Months): **$10.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 03/04/20) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**5-Strong Sell**
	Zacks Style Scores:	VGM:F
	Value: C | Growth: F | Momentum: B	

Summary

Hewlett Packard is witnessing weaker server demand due to macroeconomic uncertainties, supply constraint, and ongoing shift to cloud computing. Moreover, organizations are pushing back their investments in big and expensive technology products due to global economic slowdown concerns, which can undermine HPE's near-term growth prospects. Additionally, supply-chain disruption due to the coronavirus outbreak in China remains a major concern. Nonetheless, HPE's efforts to shift focus to higher margin offerings like Intelligent Edge and Aruba Central Hyperconverged Infrastructure is aiding its bottom-line results. Moreover, its multi-billion-dollar investment plan across expanding networking capabilities will help diversify business from server and hardware storage markets, and boost margins over the long run.

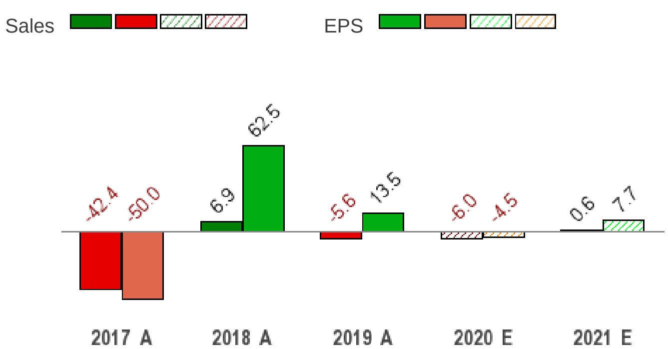
Price, Consensus & Surprise



Data Overview

52 Week High-Low	**$17.59 - $7.43**
20 Day Average Volume (sh)	**14,449,085**
Market Cap	**$12.1 B**
YTD Price Change	**-40.9%**
Beta	**1.57**
Dividend / Div Yld	**$0.48 / 5.1%**
Industry	**Computer - Integrated Systems**
Zacks Industry Rank	**Bottom 33% (169 out of 254)**
Last EPS Surprise	**2.3%**
Last Sales Surprise	**-3.5%**
EPS F1 Est- 4 week change	**-6.1%**
Expected Report Date	**05/28/2020**
Earnings ESP	**-2.5%**
P/E TTM	**5.2**
P/E F1	**5.6**
PEG F1	**0.9**
P/S TTM	**0.4**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	7,058 E	6,865 E	7,036 E	7,284 E	27,554 E
2020	6,949 A	6,736 E	7,104 E	7,361 E	27,378 E
2019	7,553 A	7,150 A	7,217 A	7,215 A	29,135 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	$0.42 E	$0.41 E	$0.42 E	$0.49 E	$1.82 E
2020	$0.44 A	$0.36 E	$0.39 E	$0.47 E	$1.69 E
2019	$0.42 A	$0.42 A	$0.45 A	$0.49 A	$1.77 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/02/2020. The reports text is as of 04/03/2020.

Overview

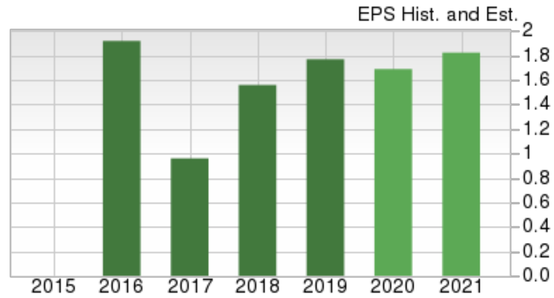
Headquartered in Palo Alto, CA, Hewlett Packard Enterprise Company was formed as a result of the split of Hewlett-Packard Company into two separate entities – one focusing on the enterprise-facing hardware and service business and the other focusing on the consumer-facing computer and printer segments.

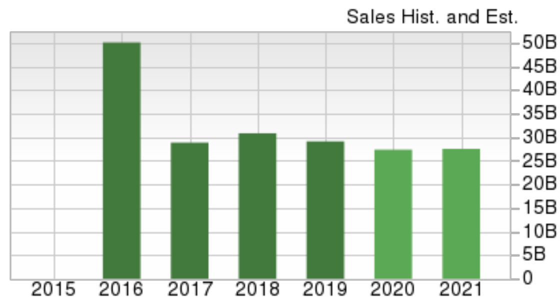
Effective Nov 1, 2015, the enterprise and service business-oriented company, Hewlett Packard Enterprise, started trading under the ticker symbol "HPE", while the PC-focused business named, HP Inc., continues to trade under the symbol "HPQ".

During fiscal 2017, the company divested its two business segments — Enterprise Services and Software. Hewlett Packard Enterprise has three reportable segments, namely Hybrid IT, Intelligent Edge and Financial Services. In fiscal 2019, the company reported revenues of $29.1 billion.

The Hybrid IT segment (78% of total revenues) includes sub-segments, such as Compute, Storage, Data Center (DC) Networking and PointNext. While Compute and Storage consist of old servers and storage segments, DC Networking comprises the wired networking portion of the earlier "networking" segment. PointNext is made up of majority of the previous "technology services" segment.

Intelligent Edge (10%) includes HPE Aruba and HPE Aruba Services, containing primarily the WLAN portion of the old "networking" segment with a small portion of the old "technology services" segment.





The Financial Services segment (12%) offers leasing, financing, IT consumption and utility programs, and asset management services.

In fiscal 2019, the United States contributed to 40% of sales and "Other" countries accounted for the rest.

The company markets and sells its products through distribution partners, resellers, original equipment manufacturers (OEMs), systems integrators, independent software vendors, and advisory firms.

The company's Hybrid IT segment is pitted against IBM, Dell, Cisco and Microsoft. Its Financial Services business faces competition from captive financing companies, mainly IBM Global Financing, as well as banks and other financial institutions.

Reasons To Buy:

> Hewlett Packard's efforts to shift focus to higher margin offerings like Intelligent Edge and Aruba Central Hyperconverged Infrastructure are expected to drive its bottom-line results in the long-run.

- ▲ Increase in worldwide IT spending spells some optimism about Hewlett Packard Enterprise's near-term performance. As per Gartner's latest forecast, global IT spending is expected to increase 3.7% in 2020. The growth will be mainly driven by increased spending by companies toward digitalization and infrastructure build-up. In its earlier report, Gartner had indicated that major technology trends that include Internet of Things (IoT), big data, artificial intelligence (AI) and blockchain have been driving overall IT spending.

- ▲ After the split from its parent company, Hewlett Packard Enterprise has made it clear that it will focus on restructuring and realigning its businesses to drive long-term sustainable growth and improvise margins. This indicates that we may see Hewlett Packard Enterprise becoming even smaller with spin offs, or acquiring assets to enhance its capabilities in the hybrid IT model. By trimming its size, the company intends to focus more on high margin businesses including enterprise class server and storage markets. Moreover, by selling assets which are not doing well and have limited growth potential, the company will be able to mobilize resources to the fast-growing areas of the cloud such as software defined networks (SDN) and converged and hyper-converged infrastructure. This will also help it to better compete with players like Oracle, Cisco and NetApp.

- ▲ The spin-off of Enterprise Services business and merger of the same with Computer Sciences has opened new avenues of growth for the combined entity as well as has unlocked value for Hewlett Packard Enterprise's shareholders. The deal has combined Computer Sciences' strength in insurance, healthcare and financial services with Hewlett Packard Enterprise's expertise in fields such as transportation, pharma, technology, media and telecom. Post-merger, the combined entity — DXC Technology — has become the world's second-largest IT services company after Accenture plc, generating revenues of approximately $21 billion annually.

- ▲ Hewlett Packard Enterprise has been pursuing acquisitions to focus more on high-margin hybrid IT models that leverage on-premises and cloud-computing power. Last year's acquisitions of Cray and MapR strengthened its capabilities in high-performance computing and data-analytics platforms. In 2018, Hewlett Packard Enterprise acquired five businesses mainly focused on expanding its footprint in the hybrid IT models. We believe the company's focus on hybrid IT model will drive growth in the long run. Some other notable acquisitions by Hewlett Packard Enterprise in the hybrid IT space are SimpliVity and Cloud Technology Partners.

- ▲ Hewlett Packard Enterprise views Artificial Intelligence (AI), Industrial Internet of Things (IoT), and distributed computing as the next major markets. Therefore, the company in 2018 decided to invest $4 billion through 2022 to enhance its capabilities across the aforementioned space. Hewlett Packard Enterprise has linked these businesses to its fast-growing networking business arm — Aruba Networks. The strategy would also help Hewlett Packard Enterprise diversify its business from server and hardware storage markets. Notably, server and hardware storage markets have been witnessing stagnant growth for the past several quarters as more and more organizations are shifting to cloud computing due to their cost-effectiveness and anywhere accessibility features. Moreover, server shipments have contracted in the second and third quarters of 2019.

- ▲ Hewlett Packard Enterprise's strong operating cash flow has helped it to return cash through regular quarterly dividend payment and share repurchases. In fiscal 2019, the company generated $4 billion of operating cash flow and returned $2.85 billion to shareholders. Share repurchases and dividend payments are good way of returning cash to investors while boosting the company's earnings. The company completed its plan to return $7 billion to shareholders in the form of share repurchases and dividends over fiscal year 2018 and 2019.

Reasons To Sell:

- Hewlett Packard Enterprise is facing weaker server demand due to macroeconomic uncertainties. The company is witnessing demand and supply disruptions for its servers due to the coronavirus outbreak in China, one of its biggest market. Capacity constraint in the North American facility is also impacting server-component supply. Furthermore, organizations are pushing back their big and expensive technology products due to a slowdown in global economic growth. Additionally, more and more organizations continue to shift to cloud computing owing to their maintenance-free and cost effectiveness compared with standalone servers.

Weaker server demand due to macroeconomic uncertainties, supply constraint, and ongoing shift to cloud computing is likely to continue hurting Hewlett Packard's near-term results.

- The acquisition of EMC by Dell has posed new challenges for Hewlett Packard Enterprise. With the acquisition, Dell has become one of the major players in the cloud services and data storage market. EMC Corporation (stylized as EMC) offers data storage, information security, virtualization, analytics, cloud computing and other products and services that enable businesses to store, manage, protect, and analyze data. VMware is its subsidiary that focuses on cloud and virtualization software and services for its parent company. Therefore, the acquisition of EMC along with its privately-controlled structure will provide Dell an unmatched scale, strength and flexibility to deepen its relationships with customers of all sizes.

- Hewlett Packard Enterprise's market share and revenues necessarily depend on client relationships and the number of contracts it secures. This, along with the limited scope for product differentiation, makes the renegotiation of large contracts extremely important. Competition from bigger companies is a major concern. Hewlett Packard Enterprise has to deal with strong competition at each of its business segments on the basis of technology, innovation, price, quality, reliability, etc. The company's Hybrid IT segment is pitted against IBM, Dell, Cisco and Microsoft. Its Financial Services business faces competition from captive financing companies, mainly IBM Global Financing, as well as banks and other financial institutions. Such intense competition across the business segments naturally increases pricing pressure, which may have a negative impact on the company's profitability.

- Usually, more than 60% of Hewlett Packard Enterprise's total revenues come from businesses outside the United States. An economic condition, which impacts the foreign currency exchange rates, results in transaction exposure, inducing fluctuation in profits. The U.S. dollar value being stronger in comparison to other currencies, the top line of the company is likely to be negatively impacted over the next few quarters.

- The United States and China's tit-for-tat trade war is a major threat to the company. Further, longer sales cycles, which are stretching the time to close certain deals is a major overhang. Execution challenges faced by the company in Intelligent Edge segment around Aruba sales are hurting its top-line growth.

Last Earnings Report

Hewlett Packard Q1 Earnings Top, Revenues Miss Mark

Quarter Ending	01/2020
Report Date	Mar 03, 2020
Sales Surprise	-3.53%
EPS Surprise	2.33%
Quarterly EPS	0.44
Annual EPS (TTM)	1.80

Hewlett Packard Enterprise Company delivered first-quarter fiscal 2020 non-GAAP earnings of 44 cents per share, beating the Zacks Consensus Estimate by a penny. The reported figure also came in higher than the year-ago number of 42 cents. Moreover, non-GAAP earnings came in at the mid-point of management's guided range of 42-46 cents.

Despite a better-than-expected bottom-line performance, HPE's shares depreciated nearly 6% in the extended trading session on Mar 3, as revenues missed the consensus mark. Additionally, the company's downbeat free cash flow outlook for fiscal 2020 turned investors cautious about its near-term performance.

Macroeconomic Factors Hurt Q1 Revenues

HPE reported net revenues of $6.95 billion, which missed the Zacks Consensus Estimate by 3.5% and declined 8% year on year. On a constant currency basis, revenues fell 7%, year over year. The company blamed weaker server demand due to macroeconomic uncertainties, supply constraint, and ongoing shift to cloud computing.

HPE cited that its supply chain has been disrupted due to the coronavirus outbreak in China. Furthermore, organizations are pushing back their big and expensive technology products due to a slowdown in global economic growth. Additionally, more and more organizations continue to shift to cloud computing owing to their maintenance-free and cost effectiveness compared with standalone servers.

Segment wise, the company registered sales contraction across all its major businesses. The Compute (43% of Q1 net revenues) division's sales decreased 16% year over year to $3.01 billion thanks to component-supply constraints, North America manufacturing capacity constraint and macroeconomic uncertainty.

Apart from the Compute segment, HPE registered sales declines across its Storage and Financial Services businesses. Revenues from Storage business fell 8% year on year to $1.25 billion. Financial Service revenues were down 7% year over year to $859 million.

Nonetheless, slight year-over-year revenue improvement across the HPC & MCS, Intelligent Edge, and A&PS segments partially offset the negative impact of soft performances in the aforementioned segments. HPC & MCS revenues climbed 6% year over year to $823 million. Revenues at the Intelligent Edge division grew 2% to $720 million during the quarter. A&PS division's sales inched up 1% year over year to $243 million.

Geographically, Hewlett Packard Enterprise's revenues in the Americas (40% of revenues) decreased 7% at cc. Also, EMEA (37% of revenues) revenues softened 10% at cc and APJ revenues (23% of revenues) fell 2% at cc.

Operating Results

HPE's non-GAAP gross margin of 33.2% expanded 210 basis points (bps) on a year-over-year basis, aided by a favorable portfolio mix, HPE Next initiatives, and commodity pricing tailwinds. Notably, for the past few quarters, the company is trying to shift focus to higher margin offerings like Intelligent Edge and Aruba Central Hyperconverged Infrastructure.

HPE's non-GAAP operating profit fell 10% year over year to $602 million. However, non-GAAP operating margin advanced 10 bps, year over year, to 9.6%, primarily on higher margins of the Intelligent Edge and A&PS businesses.

Balance Sheet and Cash Flow

HPE ended the fiscal first quarter with $3.17 billion in cash and cash equivalents compared with the $3.75 billion recorded at the end of fourth-quarter fiscal 2019.

During the reported period, Hewlett Packard Enterprise used $79 million of cash for operational activities. Free cash flow was also negative $185 million in the quarter.

Additionally, the company repurchased shares worth $204 million and paid out $156 million as dividends.

Guidance

HPE does not expect revenue growth this year due to the coronavirus-led supply-chain disruptions. Notably, during the Security Analyst Meeting last October, HPE had anticipated revenue growth of 1-3% over the next three years.

Furthermore, the company is finding it difficult to quantify the real impact of coronavirus-led demand and supply disruptions. Therefore, management didn't provide earnings guidance for the fiscal second quarter.

Also, the server maker trimmed its free cash flow outlook to $1.6-$1.8 billion from $1.9-$2.1 billion. However, it reaffirmed the non-GAAP earnings guidance range of $1.78-$1.94 per share.

Recent News

On Jan 30, 2020, Hewlett Packard announced regular quarterly cash dividend of 12 cents per share to be payable on Apr 1 to the shareholders of record date as of Mar 11.

On Jan 28, 2020, Aruba, a subsidiary of Hewlett Packard, revealed that the United States Department of Defense Education Activity upgraded its network, leveraging Aruba's wireless and security solutions to deliver secure Wi-Fi for students and faculty in 164 schools worldwide.

On Jan 21, 2020, Aruba, a subsidiary of Hewlett Packard, announced that Black Fire Innovation, a collaborative effort between Caesars Entertainment and the University of Nevada, will rollout Aruba's infrastructure in its technology incubation hub to enable the next generation of retail, entertainment and hospitality experiences.

On the same day, Hewlett Packard was selected to provide crucial AI and high-performance computing infrastructure to Zenuity to develop next-generation autonomous driving systems.

On Dec 4, 2019, Aruba announced the integration of the Aruba SD-WAN solution with the new AWS Transit Gateway Network to simplify the deployment and management of networks connecting remote branch locations to Amazon Virtual Private Clouds.

Valuation

Hewlett Packard shares lost 40.8% YTD and 41.7% over the trailing 12-month period. Stocks in the Zacks sub-industry fell 25% while the Zacks Computer & Technology sector declined 15.7% in the year so far. Over the past year, the Zacks sub-industry and the sector declined 27% and 6.3%, respectively.

The S&P 500 Index is down 23.1% YTD and 14.3% in the past year.

The stock is currently trading at 5.18X forward 12-month earnings, which compares to 7.57X for the Zacks sub-industry, 18.56X for the Zacks sector and 15.37X for the S&P 500 index.

Over the past three years, the stock has traded as high as 13.94X and as low as 4.58X with a 3-year median of 10.15X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $10 price target reflects 5.44X forward 12-month earnings.

The table below shows summary valuation data for HPE

Valuation Multiples - HPE

		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	5.18	7.57	18.56	15.37
	3-Year High	13.94	11.90	22.02	19.34
	3-Year Low	4.58	7.57	16.94	15.18
	3-Year Median	10.15	10.32	20.08	17.44
P/S F12M	Current	0.42	1.07	2.97	2.70
	3-Year High	1.01	1.87	3.59	3.43
	3-Year Low	0.37	1.07	2.62	2.70
	3-Year Median	0.74	1.54	3.19	3.15
EV/EBITDA TTM	Current	3.69	7.45	9.95	9.15
	3-Year High	13.35	9.99	12.84	12.88
	3-Year Low	3.29	6.58	8.75	8.27
	3-Year Median	4.59	8.60	11.29	11.21

As of 04/02/2020

Industry Analysis **Zacks Industry Rank:** Bottom 33% (169 out of 254)

Top Peers

Cisco Systems, Inc. **(CSCO)**	Neutral
International Business Machines Corporation **(IBM)**	Neutral
Juniper Networks, Inc. **(JNPR)**	Neutral
Microsoft Corporation **(MSFT)**	Neutral
NetApp, Inc. **(NTAP)**	Neutral
Nutanix Inc. **(NTNX)**	Neutral
Oracle Corporation **(ORCL)**	Neutral
Pure Storage, Inc. **(PSTG)**	Neutral

Industry Comparison Industry: Computer - Integrated Systems

	HPE Neutral	X Industry	S&P 500	CSCO Neutral	IBM Neutral	MSFT Neutral
				Industry Peers		
VGM Score	F	-	-	C	C	C
Market Cap	12.08 B	301.62 M	17.16 B	168.79 B	97.72 B	1,180.91 B
# of Analysts	7	3	13	12	7	14
Dividend Yield	5.12%	0.00%	2.5%	3.62%	5.89%	1.31%
Value Score	C	-	-	C	B	D
Cash/Price	0.25	0.21	0.06	0.16	0.09	0.12
EV/EBITDA	4.29	-4.71	10.80	9.02	8.13	19.24
PEG Ratio	0.86	1.19	1.74	2.34	1.54	2.14
Price/Book (P/B)	0.70	2.11	2.33	4.75	4.64	10.73
Price/Cash Flow (P/CF)	2.47	7.58	9.11	11.57	5.57	24.44
P/E (F1)	5.56	7.59	14.73	12.61	8.44	27.77
Price/Sales (P/S)	0.42	1.22	1.81	3.27	1.27	8.80
Earnings Yield	18.02%	0.00%	6.71%	7.94%	11.85%	3.60%
Debt/Equity	0.54	0.17	0.70	0.41	2.58	0.64
Cash Flow ($/share)	3.79	0.34	7.01	3.44	19.75	6.35
Growth Score	F	-	-	C	D	B
Hist. EPS Growth (3-5 yrs)	-3.49%	0.13%	10.92%	8.60%	-3.50%	17.68%
Proj. EPS Growth (F1/F0)	-4.52%	-2.97%	1.02%	1.80%	1.77%	17.68%
Curr. Cash Flow Growth	-2.58%	-1.75%	5.93%	6.95%	2.09%	19.70%
Hist. Cash Flow Growth (3-5 yrs)	-3.09%	-3.63%	8.55%	3.53%	-3.76%	11.99%
Current Ratio	0.79	1.72	1.24	1.81	1.02	2.80
Debt/Capital	35.19%	14.69%	42.33%	28.97%	72.05%	39.05%
Net Margin	4.22%	-4.01%	11.67%	21.44%	12.23%	33.02%
Return on Equity	13.68%	-1.00%	16.70%	36.40%	62.27%	40.41%
Sales/Assets	0.55	0.88	0.54	0.55	0.53	0.48
Proj. Sales Growth (F1/F0)	-6.03%	0.00%	1.54%	-3.80%	-0.57%	12.00%
Momentum Score	B	-	-	D	B	C
Daily Price Chg	-2.09%	0.11%	1.45%	3.84%	4.62%	2.07%
1 Week Price Chg	13.79%	13.25%	12.29%	9.04%	13.25%	8.99%
4 Week Price Chg	-20.44%	-25.31%	-21.33%	0.58%	-15.09%	-6.62%
12 Week Price Chg	-40.14%	-38.65%	-28.56%	-15.89%	-19.56%	-4.21%
52 Week Price Chg	-41.63%	-28.33%	-22.55%	-27.82%	-22.96%	30.08%
20 Day Average Volume	14,449,085	274,599	4,257,668	44,420,032	8,782,918	74,010,368
(F1) EPS Est 1 week change	0.00%	0.00%	-0.04%	0.00%	-0.19%	-0.29%
(F1) EPS Est 4 week change	-6.11%	-2.43%	-4.30%	-3.92%	-2.43%	-0.51%
(F1) EPS Est 12 week change	-9.49%	-9.49%	-5.47%	-3.37%	-1.25%	4.46%
(Q1) EPS Est Mthly Chg	-10.33%	-3.85%	-5.91%	-8.08%	-3.85%	-3.04%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	F
Momentum Score	B
VGM Score	F

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock.The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment.This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time.ZIR is not a broker-dealer.ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients.Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.