

ANNEX BULLETIN

Annex Bulletin 2007-21

May 16, 2007

A **CONFIDENTIAL** client edition

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Updated 5/18/07, 2:00PM PDT, updates [Market Update...](#)

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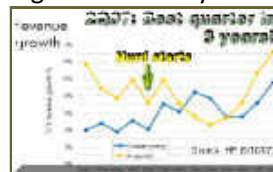
Per Ardua Ad Astra

("Through Hardships to Stars")

Hurd's Best Quarter So Far, Yet CEO Exhorts HP Troops to Reach for Loftier Goals, Greater Heights

SCOTTSDALE, May 16 - HP continues to exceed everyone expectations, except perhaps its CEO's, who keeps trying to lower Wall Street's expectations. The second quarter of FY07 has been the best quarter since Mark Hurd took over two years ago. The company is firing on all cylinders, as all its units grew in the quarter, most in double digits. But what impresses the most is that their profitability is actually growing faster than revenues. This led to a record quarterly cash flow of \$4.2 billion.

HP's net income was \$1.78 billion, or 65 cents per share. Excluding extraordinary items, the company had a per-share profit of 70 cents, up 17% over the year earlier earnings.



The company lifted a prior second-quarter profit forecast, following the inadvertent disclosure of financial data via e-mail to a single outside party. HP said on May 8 it expected to report net earnings per share of 64 cents to 65 cents, and a profit before items of 69 cents to 70 cents.



But the IBM CEO, Mark Hurd, speaking on a post-release conference call, seemed intent on dampening the exuberance. In a "per ardua ad astra" ("through hardships we reach the stars") leadership style, he exhorted his troops to reach for loftier goals and greater heights. He said that restructuring and cost-cutting still have a ways to go.

"HP is still transforming," Hurd said. "Our overhead costs are still too high. We're not

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even close to being done."

"We will take out more overhead costs in 2007, '08 and '09 than we did in 2005 and 2006," Hurd added. "We're doing better but we can do better than we're doing today."



The initial reaction to the HP second quarter results was predictably positive. The stock was up to about \$45.6 in after-hours trading, setting new multi-year highs. But then the doubts set in. But in the next day's trading (May 17), HP shares sank nearly 1% to \$44.50.

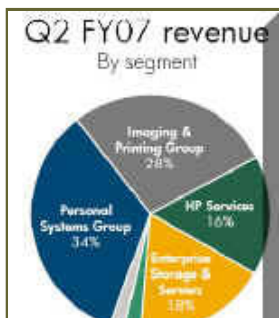
Business Segment Analysis

The best performing major product lines were the PCs, blades and the highly profitable printer supplies. They grew 24%, 58% and 10% respectively. The imaging and printing unit's operating margin of 16.3% topped all other product lines. But all product lines improved their profitability.

Revenue growth in the Americas region was also impressive, nearly doubling from the first quarter (from 6% to 11%).

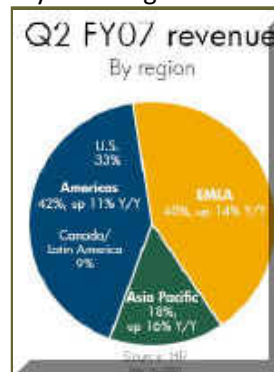
"I was highlighted by the fact we had strong revenue growth across the company," Hurd told the media and analysts.

Revenue in HP's personal systems group, which includes PCs, rose 24% to \$8.7 billion. Operating profit was \$417 million for a 4.8% margins, up from 3.6% a year ago.



In imaging and printing, revenue rose 6% to \$7.2 billion, while operating margins soared to 16.3%.

Enterprise Storage and Server (ESS) revenue grew 8% to \$4.6 billion. Operating profit was \$407 million, or 8.8% compared to 7.5% a year earlier.



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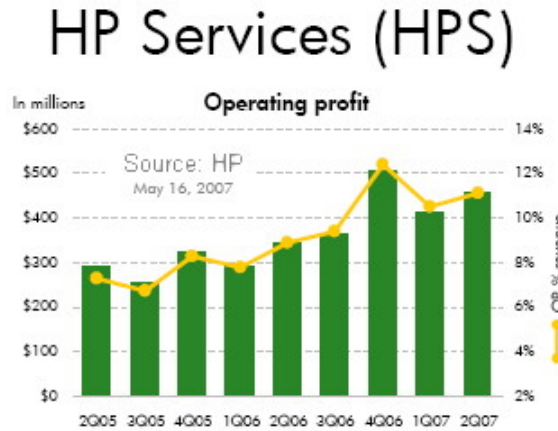
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HP's services business saw revenue climb 7% to \$4.1 billion, while its operating profit was \$459 million, or 11.1% of revenue, up from 8.9% a year ago. It was the third quarter in a row that HPS returned to double digit operating margin. Prior to Hurd's taking over as CEO, the HPS margins had dropped down to high single digits (see the right chart).



HP's software business grew 58% to \$523 million, led by strong growth from the Mercury acquisition. Operating profit was \$42 million, or 8%, up from 0.9% a year ago. The days of continuous losses in HP's software business are evidently long gone (see the left chart).



Outlook

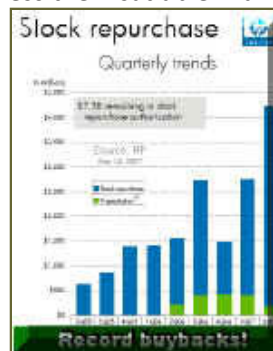
HP increased its full year earnings estimate to \$2.51 and \$2.53 a share, from \$2.35 to \$2.40 a share. The company projected its revenue will increase to \$100.5 billion to \$100.9 billion at the Oct. 31 end of its fiscal year, up from a previous forecast of \$98 billion to \$99 billion.

The forecast sent H-P's shares higher in after-hours trading to \$45.6, up from \$45.2 at the May 16 close of trading. HP shares are up more than 30% during the past 12 months.

But as you saw earlier, they closed lower on May 17, the day after the second quarter results were released. Once again, it was a case when even the best quarter was not good enough (HP received the same Wall Street treatment three months ago, after its first quarter results were released - see "[Toward New Highs?](#)" Feb 2007).

Not even the record \$4.2 billion of stock buybacks seem to impress the insatiable Wall Street traders anymore (see the right chart). Nor a promise of more such activities to come.

"We expect to continue to repurchase shares in the coming quarters," said Cathie Lesjak, the CFO, during the teleconference with analysts. "Of the \$8 billion share repurchase authorization approved by the Board on March 15, 2007, we have approximately \$7 billion remaining."



Of course, even such huge amounts are pittance compared to stock buybacks by IBM and other S&P giants (see "[To Buy \(back shares\) or Not to Buy?](#)" May 2007). So no wonder phlegmatic investors greeted them with a shrug.

[Click here](#) for detailed HP 2007 P&L forecasts by lines of business (Annex clients only)

[of latest institutional shareholdings of leading IT companies: IBM, HP, Accenture, EDS, CSC, BearingPoint, ACS, Perot \)](#) [[Annex clients click here](#)]

[Globalization Accelerates](#) (Analysis of United Nation's annual survey of global investments)

[IBM: A \\$125-Stock? \(An update to "From Small Acorns Mighty Oaks Grow"\)](#)

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[Fujitsu: Good Performance Gets Better, More Global](#) (Analysis of Fujitsu's first half FY2007 business results)

[IBM: A Slam Dunk Quarter](#) (Analysis of IBM third quarter business results)

[Accenture's Emphatic Year-end Accents](#) (Analysis of Accenture's fourth quarter results) [[Annex clients click here](#)]

[IBM: Services in a Box](#) (Analysis of IBM Global Services' Ground-shifting Announcements)

[Strong Comeback by IT Stocks in Third Quarter](#)

Happy bargain hunting!

Bob Djurdjevic

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Market Update: IBM Stock Up, HP Down on Board News

SCOTTSDALE, May 18 - A day after the IBM, two things happened that helped the IBM stock move into record territory again. First, a realization seemed to sink in on Wall Street that \$11 per share in 2010, which IBM is now forecasting, will mean over \$13 billion in net profit that year, up 42% from the \$9.5 billion IBM earned in 2006. And by the end of 2011, Big Blue's bottom line should be closing in on \$15 billion. That's a \$4 billion increase to our five-year forecast, as we suspect is to most Wall Street spreadsheets (Annex clients click on right thumbnail chart a detailed forecast update).

Second, HP made an announcement this morning that a former IBM CFO was joining its Board.



So the HP shares promptly declined, while IBM's rose to new five-year records, One could almost "see" the money flowing out of the HP stock into IBM (see above chart). For more on the reasons for that, and John Joyce's legacy at IBM check out:

"Slam-Dunk of Bunk," (Jan 19, 2000)

A Slam-Dunk of Bunk! Biggest Surprise: A Sharp Drop in ... delivering pure bunk, John Joyce has just scored a **slam-dunk!** A \$557-million loss incurred by the Bug Blue...

"A Grand Slam Dunk of Bunk:" Analysis of IBM 4Q01 Results (Jan 18, 2002)

John **Joyce**, bravely drove the Big Blue ... truckloads of bad news. When **Joyce** pulled the same stunt two ... Jan 19, 2000). This afternoon, **Joyce** has outdone himself. Make it "**A Grand Slam Dunk of Bunk**"...

"Joyce Invents 'Rescoping':" Analysis of IBM Second Quarter Results (July 17, 2002) ...Joyce rejoiced (that) IGS's backlog declined in the second

(Analysis of top 20 IT companies' market and business trends)

Stock Buybacks: A Fading Fad (Dell, erstwhile "King of Fluff," suspends its stock buybacks)

Capgemini: Growth Continues (Revenues, net profit up in double digits, margins also improve)

HP Firing on All Cylinders (Stock sets new multi-year record following excellent third fiscal quarter results) [Annex clients click here]

Power of Manpower (While others move to India, Russia... AMD invests in New York, hailing "phenomenal" quality of its labor force)

Ebb Tide Lowers Most Boats (Analysis of EDS' and CSC's latest quarterly results)

IBM Stock Grossly Undervalued? (Analysis of stock market valuations of IBM and its major competitors) [adds latest Fujitsu, Capgemini results]

IBM vs. HP: A Tale of Two Blues (Both companies are doing well in business, but only HP is favored by Wall Street; Big Blue trying to change that now with its new "India Opus") [Annex clients click here]

Go East, Young Man! (A speech delivered in St. Petersburg, Russia, May 25, 2006; click here for slides)

IBM 5-Yr Forecast: Steady As She Goes (Emphasis on quality continued) [Annex clients click here]

Octathlon 2006: Accenture

quarter for the first time ever! That was evidently due to, what IBM now calls, "rescoping" - a "new English" word. It has been coined to depict the old-fashioned customer renegeing, or contract renegotiations, coupled with the usual cancellations and expirations...



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Volume XXIII, Annex Bulletin 2007-21
 May 16, 2007

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[Again Wins "Gold!" \(HP gets "Silver," IBM "bronze"\)](#)
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