ANNEX BULLETIN

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INDUSTRY TRENDS

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Analysis of Hewlett-Packard's First Quarter FY07 Business Results

Toward New Highs?

Revenue Grows in Double Digits; Profit Surges 31%

NEW YORK, Feb 20 - Hewlett-Packard's Mark Hurd did it again. Once again, his company has exceeded Wall Street expectations. And once again, HP did it the hard way - by growing both revenues *and* profits at the same time.

First quarter revenues rose 11% to $25.2 billion, while net earnings jumped 31% to $1.8 billion. And upward trends were evident in *all* of HP's lines of business. That's more than just music to Wall Street ears; that's pure symphony.

No wonder the HP stock rose to $43.13 in regular trading in anticipation of another solid quarter, closing just shy of the multi-year high set last month.

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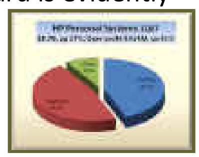
"This was a solid start to (the) year, (as) revenue grew, margins expanded and we continued to take market share," Hurd told the media after the results were release, but prior to the analyst teleconference.

Ironically, the HP shares gave up most of the earlier gain in after-hours trading despite its stellar latest business results. Go figure... Wall Street has never been known to overdose on logic.

Business Segment Analysis

PCs. Take the PC unit, for example. Yes, HP competitors, like Dell and Lenovo, have had their share of problems lately. But HP has had little to do with that. Hurd is evidently not the kind of CEO who "buys the business," as they say (drops prices and sacrifices profits to gain market share). HP's PC revenues grew 17% to $8.7 billion, while its corresponding operating profit rose 41% to $414 million since a year ago period.



Some of the HP growth in the PC business has clearly come at Dell's expense. But most of it seems to be coming from consumer markets. The holiday season has certainly given HP a big boost. They surged by 28% in the quarter (vs. 8% rise of commercial PC revenues and a 1% drop in desktop business). Notebook sales now account for nearly half of the total (see the chart). Maybe that's why Michael Dell beefed up his executive team yesterday by adding former Motorola executive to head up its consumer business?

Imaging & Printing (I&P). The most profitable HP business continues to be, well, the best. The I&P revenue grew 7% to $7.0 billion, while operating profit rose 13% to $1.1 billion. At a 15.3% operating margin, up from 14.9% a year ago, this is by far the most profitable HP unit.

Within the above totals, the supplies revenue, at 58% the largest I&P sub-segment, grew 11%, while the commercial hardware revenue grew 2% and consumer hardware was flat. Unit shipment volumes increased in all of the I&P product lines, some in high double digits.

Enterprise Servers & Storage (ESS). The ESS revenues rose 5% to $4.5 billion, while its operating profit jumped 28% to $416 million. While the corresponding operating margin of 9.3%, up from 7.7% a year ago, is the second best on record, not everything has turned up roses in this unit.

A 6% decline in "business critical servers," for example, was one of the few blemishes in an otherwise excellent quarter. The drop confirms that Sun Microsystems has been gaining share from HP in the Unix market, as was also evident from Sun's last month's excellent business results.

Asked to explain this blemish during the conference call, Hurd felt the drop was mostly due to relatively poor execution in this quarter, and should not be taken as a sign of any long-term malaise.

Meanwhile, HP's industry-standard (Intel-based) server revenue, the largest ESS sub-segment (60% of total), increased 10%, with blade revenue up 45%. Storage revenue

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HP: New King of the Hill *(Analysis of HP's fourth quarter business results)*

IBM: From Little Acorns Mighty Oaks Grow *(Analysis of IBM's "State of the Union")*

Capgemini: By Leaps and Bounds *(Analysis of Capgemini's preliminary third quarter business results)*

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

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

Stock Buybacks: A Fading Fad *(Dell, erstwhile "King of Fluff," suspends its stock* rose 3%.

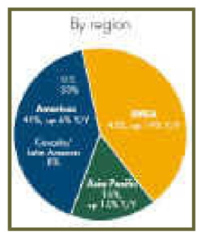
Services (HPS). HP Services was the company's most-improved operation this quarter in terms of profitability. Its operating profit soared by 41% to $414 million, equaling the PC unit's total on less than half the revenues ($3.9 billion, up 5%). The HPS operating margin of 10.5% represents nearly a three-point jump from a year ago (7.8% of revenue).

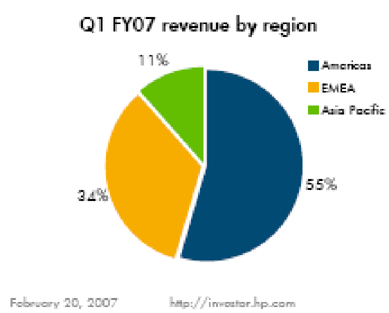
The Technology Services (maintenance), HPS' biggest segment at 54% of total revenue, grew 1% over the prior year period. Consulting & Integration and Outsourcing sub-segments were up 10% and 11% respectively.

Software. HP Software, on the other hand, received the biggest revenue boost of any HP unit. Benefiting from the Mercury acquisition, software surged 81% to $550 million. Operating profit was $47 million, or 8.5% of revenue, up from a profit of $9 million, or 3.0% of revenue, in the prior year period. And that's despite a write-down of certain costs and expenses related to the Mercury purchase. So it would seem fair to say that at HP, Mercury is rising. ☺

Excluding the effects of the Mercury acquisition, which closed in November, revenue increased 7% over the prior year period. HP OpenView grew 14% while HP OpenCall dropped 6%.

Geographies. Asia/Pacific was HP's fastest growing region in the quarter, rising 15% to $4.0 billion (up 12% in constant currency). Europe, the company's largest geographic unit, was also up in double digits as reported (up 14$ to $10.7 billion), but it rose only 6% in constant currency. The Americas region, the second biggest, grew 6% to $10.4 billion.





Financial Services. Financial Services' revenues grew by 10% to $547 million. They generated $32 million of operating profit for a margin of 5.9%. Including the Corporate Investments, this business segment grew 12.4% to $704 million.

About 55% of the total came from the Americas region, with Europe accounting for just a little over one third.

Outlook and Market Valuation

Commenting about the outlook for the second quarter, the new HP CFO Cathie Lesjak raised the revenue guidance, both for the quarter and the full year.

"We now expect second-quarter revenue to be approximately $24.5 billion, versus the current consensus estimate of $24.1 billion," she said. "Historically, revenue was roughly flat in constant currency from Q1 to Q2."

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 Again Wins "Gold!" *(HP gets "Silver," IBM "bronze") [Annex clients click here]*

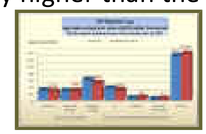
Thanks in part to a stronger than expected first quarter, HP boosted its full year revenue estimate to between $98.0 billion to $99 million, up from its prior guidance of $97 billion.

Lesjak also lifted the earnings estimates, both for the next quarter (to approximately $0.63 to $0.64 per share), and for the full year and full-year fiscal 2007 (to $2.60 to $2.65 per share), up from the prior guidance of $2.48 to $2.53, and versus current consensus estimates of $2.57.

"So all-in-all, we have a lot of work to do but lots of opportunities as well," Hurd said in his closing remarks. "I think it's a solid start to the year, and I am confident that we can continue to execute with discipline and deliver a year of strong financial returns."

In short, it looks like HP leaders think that the good news they've just reported for the first quarter will get better as the year goes on. Yet investors traded down the HP shares by 1.3% in after-hours session. Go figure, as we've said earlier.

Meanwhile, we find that the aggregate component value is now slightly higher than the actual HP market cap (click on the chart right to enlarge). So the stock appears to be pretty much priced in line where it should be relative to the P/E ratio of its various competitors. Anything much higher than that, could be considered a premium. And rationalizing that would require some logic and sanity. Maybe tomorrow morning?



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

Happy bargain hunting!

Bob Djurdjevic

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