

# Sluggish PC, ink sales hurt HP

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SAN FRANCISCO (AP) - Hewlett-Packard Co.'s 19 percent drop in quarterly profit shows that the company still relies heavily on printer ink and the troubled personal computer market, despite the aggressive transformation it's undertaking to branch out and encroach more on rival IBM Corp.'s turf.

IBM, which ditched its PC division as part of a major facelift over the past 15 years, now makes most of its money from software and services. With its \$13.9 billion acquisition last year of technology services company Electronic Data Systems, HP now too is heavily invested in services — they are its biggest revenue and profit generator.

But HP's latest quarterly numbers, reported Tuesday after the market closed, show the companies are still very different.

HP's profit dropped in large part due to ongoing weakness in sales of PCs and printer ink — two areas IBM isn't in. Still, HP edged past Wall Street's profit and sales forecasts — something CEO Mark Hurd has done most quarters in his 4 1/2 years at HP's helm.

Expectations were high going into Tuesday's report: HP's stock has risen 75 percent since March. Although the results edged out analysts' estimates, investors sent shares down 96 cents, or 2.2 percent, to \$43 in extended trading. The stock closed Tuesday's regular session up 85 cents, or 2 percent, at \$43.96.

The numbers were good and "the guidance is a relief," said Jayson Noland, an analyst with Robert W. Baird & Co. "Their commentary though is what I would focus on: conditions are stabilizing, and some of the cyclical businesses should show a rebound next year."

But HP offered "no big surprises, ho hum," he added. "I don't expect the stock to do much one way or the other. (The stock) has been very strong."

Ink has long been HP's cash cow, but is coming under pressure from generic, cheaper brands. HP's revenue from printing supplies, which includes ink, was down 13 percent in the three months ended July 31.

HP's PC division posted an 18 percent sales decline, despite improvement in consumer spending, strength in China, and a 2 percent increase in unit shipments. The discrepancy is explained by the fact that PC makers have been slashing prices, a trend that has also hurt HP's rivals.

Dell Inc., the No. 2 PC maker after HP, is expected to post a 23 percent sales drop

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when it reports quarterly numbers Aug. 27.

HP has been reluctant to call a bottom in the PC market, as chip maker Intel Corp. did in April — one of the first bullish signs about a turnaround in that sector.

"We're encouraged I think by the stability that we're beginning to see in the market, but we're not yet at a point where we're ready to call it a turn," Hurd said on a conference call with analysts Tuesday evening.

Cathie Lesjak, HP's chief financial officer, said in an interview that PC demand appears to have "stabilized."

Lesjak said the decline in printing supplies revenue was mostly caused by currency fluctuations and changes in the way HP manages inventory at resellers. She said she expects the supplies business to improve over the next couple of quarters.

HP's printer division makes up 21 percent of its overall revenue. The PC division makes up 31 percent.

In the latest quarter, HP earned \$1.64 billion, or 67 cents per share, compared with \$2.03 billion, or 80 cents per share, a year earlier. Excluding one-time items, HP earned 91 cents per share, a penny better than the average estimate of analysts polled by Thomson Reuters.

Sales fell 2 percent to \$27.45 billion, slightly ahead of analysts' projections for \$27.26 billion. Sales would have risen 4 percent were it not for currency fluctuations.

The combined HP-EDS had \$8.47 billion in services revenue in the latest quarter. It's hard to compare that to last year, though, because the numbers HP has released don't compare directly year-to-year. HP says that's because EDS wasn't a part of HP at this time last year, and the companies are still being integrated.

In IBM's latest quarter, the Armonk, N.Y.-based company's net income rose 12 percent to \$3.1 billion, while sales fell 13 percent to \$23.3 billion. It raised its full-year 2009 guidance to at least \$9.70 per share from \$9.20 per share.

Aggressive cost-cutting has been a major help to both companies' finances.

IBM has cut thousands of workers, including some 5,000 U.S. employees earlier this year from the services division. Overall headcount keeps growing because workers are added in other areas, often in lower-cost regions.

HP is cutting 24,600 jobs as part of the EDS acquisition and in May announced a separate round of 6,400 cuts involving workers from the product divisions. HP had about 320,000 workers before the layoff plans were announced.

Baird's Noland said HP management isn't talking as much about ongoing cuts because "there's a little bit of investor fatigue on cost-cutting. It's been the

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message for so long, you want to hear about some revenue growth and strategy initiatives as well."

HP's outlook for the fiscal fourth quarter was better than expected.

HP expects profit of \$1.12 per share, excluding one-time items, in the current period — above analysts' average estimate of \$1.07 per share. HP's forecast for revenue to rise about 8 percent quarter-over-quarter is in line with analyst estimates. The company also reaffirmed its full-year 2009 revenue outlook.

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