

HEWLETT-PACKARD

HP Board Replaces Leo Apotheker with Meg Whitman - on a Permanent Basis

On Thursday, the Board of HP announced that the company would be replacing Leo Apotheker with former eBay CEO and current board member, Meg Whitman. Ray Lane, who had been serving as non-executive Chairman, is now executive Chairman. Changes are effective immediately and the Board will be reduced to 13 members from 14.

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On a conference call, Lane lauded Whitman's operational and communication skills, along with her ability to manage an executive team on message. Whitman committed to the major recent strategic moves made by Apotheker, including an evaluation of the potential spin-off of the PC's business and the pending acquisition. While Whitman did not offer any solutions to HP's many problems, she hinted that a more comprehensive plan was forthcoming. The evaluation of PC's should be completed by year-end.

We continue to believe the disruption at HP could prove positive for other PC competitors such as Dell and Apple given potential for disruptions that include shelf space reductions and a lack of focus. We also note that IBM and Dell could potentially benefit from any disruptions at HP in terms of server sales, while NetApp and EMC would be positioned to benefit in storage.

HPQ: Quarterly and Annual EPS (USD)

FY Oct	2010		2011		2012			Change y/y	
	Actual	Old	New	Cons	Old	New	Cons	2011	2012
Q1	1.07A	1.36A	1.36A	1.36A	N/A	N/A	1.15E	27%	N/A
Q2	1.09A	1.24A	1.24A	1.24A	N/A	N/A	1.15E	14%	N/A
Q3	1.08A	N/A	N/A	1.10A	N/A	N/A	1.13E	N/A	N/A
Q4	1.33A	N/A	N/A	1.13E	N/A	N/A	1.28E	N/A	N/A
Year	4.58A	N/A	N/A	4.84E	N/A	N/A	4.78E	N/A	N/A
P/E	N/A		N/A			N/A			

Source: Barclays Capital
Consensus numbers are from Thomson Reuters

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PLEASE SEE ANALYST(S) CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 5.

Stock Rating **RS-RATING SUSPENDED**

Sector View **1-POSITIVE**
Unchanged

Price Target **N/A**

Price (22-Sep-2011) **USD 22.80**
Potential Upside/Downside **N/A**
Tickers **HPQ**

Market Cap (USD mn) **47647**
Shares Outstanding (mn) **1986.97**
Free Float (%) **99.77**
52 Wk Avg Daily Volume (mn) **20.8**
Dividend Yield (%) **1.5**
Return on Equity TTM (%) **23.04**
Current BVPS (USD) **19.39**

Source: FactSet Fundamentals

Price Performance **Exchange-NYSE**
52 Week range **USD 49.39-22.13**



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U.S. IT Hardware

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HP Board Replaces Apotheker with Meg Whitman on a Permanent Basis

Whitman is In: On Thursday (9/22), the Board of Directors of HP announced that the company would be replacing current CEO Leo Apotheker with former eBay CEO and current board member Meg Whitman who will also serve as President. As part of the announcement from HP, Ray Lane, who had been serving as non-executive Chairman is now executive Chairman of the Board of Directors. The changes to HP's leadership are effective immediately and the Board of Directors will be reduced to 13 members from 14 members. Meg Whitman joined HP's Board of Directors this past January after a bid to become California's governor. Whitman is most well know for her time spent as President and CEO of eBay, where she served in those roles from 1998 to March 2008. Prior to joining eBay, Whitman held executive level positions at Hasbro, FTD, The Walt Disney Company, and Bain & Company. Shares of HP are down 46% since the announcement of Apotheker's hiring on 9/30/10 (S&P down 1%). Compensation packages for Lane and Whitman are not yet finalized.

Apotheker's Strategy Still in Play: It is important to note that Whitman's role is intended to be permanent and not interim. On a conference call, Lane lauded her operational and communication skills, along with her ability to manage an executive team on message. Whitman committed to the major recent strategic moves by Apotheker, including an evaluation of the potential spin-off of the PC's business and the company's pending acquisition. While Whitman did not offer any solutions to HP's many problems, she hinted that a more comprehensive plan was forthcoming after an evaluation period. The evaluation of the PC business should be completed by year-end, stating it will only implement a spin-off if it makes the unit stronger for customers and shareholders.

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Lane Cites Whitman's Execution and Communication Skills: On its conference call, we were very surprised to see HP issue a mid quarter update – given 4Q11 doesn't end for another six weeks. HP's CFO Cathie Lesjak stated that she was confident in HP's ability to achieve its F4Q EPS guidance of \$1.12-\$1.16, but she was less confident in the revenue forecast of \$32.1-\$32.5 billion. Lesjak cited macro-economic headwinds hurting hardware sales, but stated HP had gained share through C3Q. We would be surprised if HP was gaining share in any major segment right now given our checks – with no exceptions. Also, at 35% of sales, HP has significant exposure to Europe, which could also be a factor impacting HP's momentum as well. Since Mr. Apotheker took over as CEO, HP's execution had suffered in all of its major businesses, including printers. The company had cut earnings guidance in each of Mr. Apotheker's previous three conference calls as CEO, while also issuing a \$7 EPS target for FY14 in March – only to withdraw it in August. The style in which issues were communicated with investors and stakeholders in August seemed to have a particular impact on the Board's decision.

Awaiting Plans Around Retention and a Fix for Services: In terms of major concerns, Whitman cited HP's talented employees but mentioned the company may lose some people. We believe the Board and Whitman need to move quickly to secure key executives

like David Donatelli, Executive VP and General Manager – HP Enterprise Servers, Storage, Networking and Technology Services, Vyomesh Joshi, Executive VP, Imaging and Printing Group and Todd Bradley, Executive VP, Personal Systems Group. Whitman and Lane did not address (and will need to eventually re-address) how the company plans on improving its margins and execution in key businesses like services. Another issue that seems increasingly important is sharp drop off in server sales, particularly Unix servers – which carry profitable maintenance streams.

Impact on Sector: Opportunities for Share Gains, But Economic Pressures Should Be Noted

Economy Issue Raised: In terms of assessing the impact on the IT Hardware sector, it seems several companies are set to benefit from any prolonged distractions at HP. In particular, HP's PC, Unix server and services business seems to be struggling. However, even usual areas of strength like printers and x86 servers are showing signs of weakness – and our checks show others gaining share in storage. HP's consumer-related revenues were down 15% in F3Q, which we believe points to challenges in global retail. HP has become more price-aggressive in PCs and inkjet printers, in moves that seem aimed at reducing channel inventory. Margins in both businesses seem to be trending lower.

HP's comments on the economy – while obvious – bear watching for all companies in the sector. Also on the call, HP reiterated concerns around key markets like Federal and Europe. Outside of IBM and Apple, we have recently cut numbers for every stock in our coverage universe – and HP is either a competitor or customer of each. Apple may be more “immune” only because its iPad and Mac are taking share from struggling PC vendors.

PC Announcement Disrupting HP Sales: Whitman recommitted to some key portfolio shifts at HP, but details are still lacking. Investors are eager to learn how or if key businesses will be separated from HP. In August, HP reported that it is exploring strategic alternatives for its PC business or Personal Systems Group (PSG), including the consideration of a full or partial separation of PSG from HP through a spin-off or other transaction. HP also said that it plans to discontinue operations for its webOS devices, specifically the TouchPad and webOS phones, which lost about \$300 million last quarter. HP will continue to explore options to optimize the value of webOS software.

The announcement of the potential PC divestiture has been very disruptive to HP based on our observations within the supply chain and in talking to key customers in distribution. For the four quarters ending in August 2011, HP's PSG business generated \$39.7 billion in revenues and \$2.3 billion in operating profits (a margin of about ~6%). If the decision by HP takes too long or is not well executed, the share shifts could be material. We believe HP's PC division relies heavily on the printer division for funding promotions, co-marketing and influencing shelf space decisions at retail. In terms of corporate PC sales, we believe the PSG division benefits from having a strong x86 server offering and the HP brand in the data center. Also, we believe that HP's component costs benefit from a bigger base of computing products, which will be cut dramatically after any separation (influence in ordering common parts, etc.).

In terms of the overall PC market, our checks confirmed the well-known view that 2Q11 was weaker than expected in notebooks (down 10% q/q in builds) due in large part to tablet demand (notebooks down q/q more than normal) – with cuts led by HP and Acer. Furthermore, our checks in Asia still point toward local Chinese vendors still gaining PC share from HP in that important region. The outlook for 4Q global PC demand is still

uncertain. All things considered, given the rise of tablets, we still do not see upside to PC forecasts this year – which could continue to pressure HP's PSG revenue.

Competitors Stand to Benefit – with Apple Already Providing Major Disruptions

The weaker economy could hurt many companies in our sector but on a relative basis – HP's situation could provide a benefit. To that end, we continue to believe the disruption at HP could prove positive for other PC competitors such as Dell and Apple given potential for disruptions that include shelf space reductions and a lack of focus. We believe HP's move shows Apple is disrupting and winning with the iPad. Also, the discontinuation of webOS marks another move that validates the growing dominance of Apple, in our opinion. Unlike smartphones, we do not believe any non-Asia based tablet player is having any success against Apple. Dell is already re-thinking its own plans for tablets and smartphones. We reiterate our 1-OW/1-Pos rating for Apple, which seems to be a bit of a defensive play given its share gains and strong balance sheet.

We also note that IBM and Dell could potentially benefit from any disruptions at HP in terms of server sales (HP has #1 unit share world wide) and NetApp and EMC could benefit in storage (HP is #4 in external storage revenue share worldwide). In terms of services, IBM may see some outsourcing wins vs. HP over time if dislocation persists. For IBM's 3Q11, we forecast services bookings of \$12.1 billion, which may lack upside given weakness in the Public segment. That said, it remains to be seen how dislocation in the financial services sector impacts IBM's bookings. In 2008 and 2009 consolidation actually had a positive impact on the financial services verticals' performance in IBM's services segment. Our rating for IBM is 2-EW/1-Pos.

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Primary Stocks (Ticker, Date, Price)

Hewlett-Packard (HPQ, 22-Sep-2011, USD 22.80), RS-Rating Suspended/1-Positive

Materially Mentioned Stocks (Ticker, Date, Price)

Apple, Inc. (AAPL, 22-Sep-2011, USD 401.82), 1-Overweight/1-Positive

Dell Inc. (DELL, 22-Sep-2011, USD 14.00), 2-Equal Weight/1-Positive

EMC Corp. (EMC, 22-Sep-2011, USD 20.51), 1-Overweight/1-Positive

IBM Corp. (IBM, 22-Sep-2011, USD 168.62), 2-Equal Weight/1-Positive

NetApp, Inc. (NTAP, 22-Sep-2011, USD 35.04), 1-Overweight/1-Positive

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In addition to the stock rating, we provide sector views which rate the outlook for the sector coverage universe as 1-Positive, 2-Neutral or 3-Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

Stock Rating

1-Overweight - The stock is expected to outperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.

2-Equal Weight - The stock is expected to perform in line with the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.

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Sector View

1-Positive - sector coverage universe fundamentals/valuations are improving.

2-Neutral - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

3-Negative - sector coverage universe fundamentals/valuations are deteriorating.

Below is the list of companies that constitute the "sector coverage universe":

U.S. IT Hardware

3D Systems Corp. (DDD)

EMC Corp. (EMC)

Ingram Micro Inc. (IM)

Seagate Technology (STX)

Apple, Inc. (AAPL)

Hewlett-Packard (HPQ)

Lexmark International (LXK)

Tech Data Corp. (TECD)

Dell Inc. (DELL)

IBM Corp. (IBM)

NetApp, Inc. (NTAP)

Western Digital Corp. (WDC)

IMPORTANT DISCLOSURES CONTINUED

Xerox Co. (XRX)

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IMPORTANT DISCLOSURES CONTINUED

Hewlett-Packard (HPQ)

USD 22.80 (22-Sep-2011)

Stock Rating

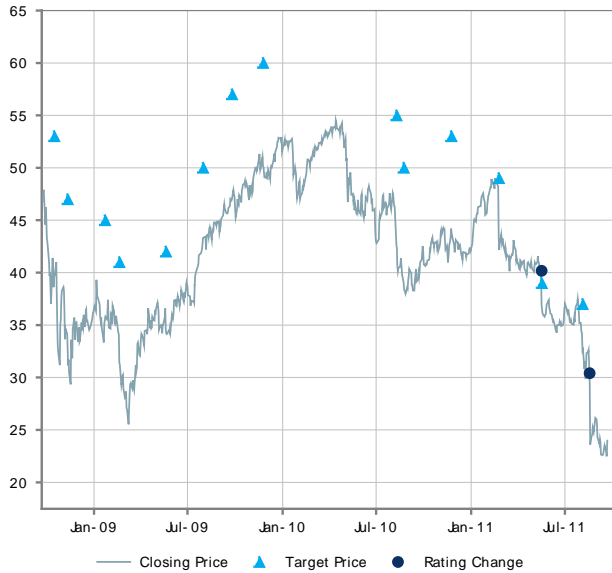
RS-RATING SUSPENDED

Sector View

1-POSITIVE

Rating and Price Target Chart - USD (as of 22-Sep-2011)

Currency=USD



Date	Closing Price	Rating	Price Target
18-Aug-2011	29.51	RS-Rating Suspended	
04-Aug-2011	32.54		37.00
17-May-2011	36.91	2-Equal Weight	39.00
23-Feb-2011	43.59		49.00
23-Nov-2010	44.19		53.00
23-Aug-2010	39.04		50.00
09-Aug-2010	42.60		55.00
24-Nov-2009	50.19		60.00
25-Sep-2009	47.02		57.00
31-Jul-2009	43.30		50.00
20-May-2009	34.67		42.00
19-Feb-2009	31.39		41.00
22-Jan-2009	35.49		45.00
11-Nov-2008	33.25		47.00
16-Oct-2008	39.66		53.00

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Valuation Methodology: Rating Suspended

Risks which May Impede the Achievement of the Price Target: Rating Suspended

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