

Hewlett Packard Enterprise (HPE - \$14.75 - NYSE) Resilient Infrastructure Leader - Buy

<u>FYE 10/31</u>	<u>Non-GAAP EPS</u>	<u>P/E</u>	<u>PMV</u>		
2021P	\$1.95	7.6x	\$24	Dividend: \$0.45	Current Return: 3.1%
2020P	1.80	8.2	23	Shares O/S: 1,346 million Common	
2019E	1.69	8.7	21	52-Week Range: \$17.59 - \$12.09	
2018A	1.48	10.0	---		

COMPANY OVERVIEW

Headquartered in Palo Alto, California, Hewlett Packard Enterprise (HPE) is a global provider of services-led and software-enabled infrastructure and solutions including secure, software-defined servers, storage, data center networking and HPE PointNext services; and financial services.

Reason For Comment

We are reiterating our Buy recommendation on Hewlett Packard Enterprise, as our best idea for 2H 2019 in Technology.

- We believe IT market will continue to demonstrate resiliency in spite of macro-economic uncertainties. HPE has been maintaining its cautious optimistic stance. It reported that macroeconomic uncertainties created pauses and elongated sales cycle, yet demand is still present. We also believe IT hardware companies have demonstrated global supply chain flexibility to navigate and mitigate United States-China tariffs.
- HP Enterprise is a market leader in hybrid IT infrastructure with secular sustainable long-term growth opportunities.
 - HP Enterprise is well positioned to capitalize on multiple growth drivers including Hybrid IT infrastructure, migration to cloud, software-defined infrastructure, hyper-converge solutions, Mobile First architecture, Edge Computing, and shift-toward –as-a-Service/consumption model in its market.
 - In high growth Intelligent Edge business, HPE is recovering from its go-to-market execution issues in North America, reported in May 2019, where sales cycle took longer and management identified weaker than expected sales productivity. HPE is improving its sales coverage model, deploying additional sales specialists, and refining its compensation structure.
 - We like management’s discipline and smart selection of recent acquisitions: CRAY (pending), Nimble Storage, Simplivity, and Blue Data.
- Improving Operating Profitability and Free Cash Flow.
 - HPE is strategically shifting toward more profitable offerings of Products and Services.
 - HP Enterprise’s free cash flow generation is getting stronger and stronger, with lower and lower one-time cash spending, and approaching its normalized free cash flow. Free cash flow is expected to double from FY 2018 to FY 2020 (Table 1).
 - The company has demonstrated solid performance in its 1H FY 2019. Management has raised its FY 2019 non-GAAP EPS earnings twice, from its original guidance of \$1.51-1.61 to current guidance of \$1.62-1.72. Management is targeting 6-8% operating profit growth in FY 2019.

Table 1 Stronger and Stronger Free Cash Flow

	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>
Revenue Growth	~7% growth adj. for Tier 1	Growth adj. for Tier 1 and FX	
Non-GAAP operating profitability	9% operating margin	6-8% operating profit growth	
Non-GAAP EPS	Adjusted \$1.45	\$1.56-1.66	
Free Cash Flow	\$1.1B	\$1.4-1.6B	\$1.9-2.1B
Normalized Free Cash Flow	\$2B	\$2.1-2.3B	\$2.3-2.5B
Capital Return	\$3.6B share repurchases \$0.6B dividend	\$2.3B share repurchases \$0.6B dividend	

Source: Company data

Table 2 Hewlett Packard Enterprise Financial Summary (2017A – 2023P)

(\$ in millions, except per share data)

<u>FYE 10/31</u>	<u>2017</u>	<u>2018</u>	<u>2019E</u>	<u>2020P</u>	<u>2021P</u>	<u>2022P</u>	<u>2023P</u>	<u>18A - '23P</u> <u>CAGR</u>
Revenue	\$28,871	\$30,852	\$29,848	\$30,304	\$30,812	\$31,337	\$31,882	0.7 %
EBITDA (Operating Cash Flow)	4,897	4,925	4,984	5,277	5,424	5,540	5,693	2.9
Non-GAAP EPS	\$0.94	\$1.48	\$1.69	\$1.80	\$1.95	\$2.05	\$2.15	7.8
EV/EBITDA	6.0	5.4	5.3	4.8	4.6	4.4	4.3 x	
Non-GAAP P/E	15.6	10.0	8.7	8.2	7.6	7.2	6.9	
Capex	3,137	2,956	2,498	2,447	2,376	2,342	2,318	

Source: Company data and g.research estimates

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- Margin of Safety
 - HP Enterprise carries attractive valuation. Shares trade at 4.8x EV/EBITDA and 8.2x non-GAAP P/E based on our October FY 2020 projection, and also have a 3.1% current return.
 - HP Enterprise has a solid capital allocation strategy. The company is targeting around \$2.9 billion of capital return for October FY 2019 through dividends and share repurchases.
- Risks include: global IT spending in light of macroeconomic environment and uncertainties, market competition, and management's execution on cost saving initiatives and shifting to more profitable growth.

Investment Case

We have a Buy recommendation. HPE possesses market leadership in server and a competitive portfolio in hyper converge and hybrid IT infrastructure. Positive catalysts include sustainable growth, strategic portfolio shift toward higher value products and services, execution on major cost savings, operating margin expansion and a solid capital return strategy.

Table 3 HP Enterprise Private Market Value Analysis 2017A – 2023P

FYE 10/31 (in \$ millions, except per share data)	2017	2018	2019E	2020P	2021P	2022P	2023P	18A - '23P CAGR
Hybrid IT + Intelligent Edge								
Revenue	\$25,661	\$27,418	\$26,383	\$26,845	\$27,297	\$27,766	\$28,253	0.6 %
EBITDA	2,379	2,701	2,722	2,954	3,118	3,213	3,332	4.3
Valuation Multiple	9.0x	9.0x	9.0x	9.0x	9.0x	9.0x	9.0x	
Segment Value	\$21,414	\$24,305	\$24,496	\$26,590	\$28,064	\$28,915	\$29,987	
HP Financial Services								
Revenue	\$3,602	\$3,671	\$3,645	\$3,699	\$3,755	\$3,811	\$3,868	1.1 %
EBITDA	2,609	2,315	2,360	2,402	2,385	2,408	2,441	1.1
Segment Value @Book Value	\$1,612	\$1,614	\$1,646	\$1,679	\$1,713	\$1,747	\$1,782	
Corporate overhead costs								
Operating income (loss)	(91)	(91)	(97)	(80)	(80)	(80)	(80)	
Valuation Multiple	4.0x	4.0x	4.5x	4.5x	4.5x	4.5x	4.5x	
Segment Value	(\$364)	(\$364)	(\$437)	(\$360)	(\$360)	(\$360)	(\$360)	
Total Private Market Value	22,662	25,555	25,706	27,909	29,416	30,302	31,409	
Plus: Net Cash	5,800	3,100	975	535	391	423	654	
Less: Minority Interest	(39)	(35)	(43)	(43)	(43)	(43)	(43)	
Less: Options Payments (a)	(715)	(801)	(801)	(888)	(931)	(975)	(1,018)	
Plus: Equity ownership of H3C	2,304	2,304	2,304	2,304	2,304	2,304	2,304	
Equity Private Market Value	29,636	29,727	27,744	29,421	30,741	31,615	32,909	
Shares Outstanding	1,595	1,423	1,322	1,298	1,284	1,278	1,277	
PMV per share	\$19	\$21	\$21	\$23	\$24	\$25	\$26	
Current Market - Discount to PMV		29.8%	29.8%	35.9%	38.5%	41.0%	43.3%	

(a) After-tax payments to buy out options holders at Private Market Value

Source: Company data, g.research estimates.

HP Enterprise Price Performance



Source: Reuters.com. As of December 5, 2016 HPE had a BUY recommendation

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