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Annex Bulletin 2007-43

November 19, 2007

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SCOTTSDALE, Nov 19 - One year ago, Hewlett Packard (HP) became the new "king of the hill" of the IT industry, having surpassed Big Blue in total revenues (\$91.7 billion vs. \$90 billion - see "[New King of the Hill](#)," Nov 2006). Today, HP widened its lead over IBM, as its fiscal year 2007 revenues surged 15% to \$104.3, up 14% since a year ago. IBM revenues for the last four quarters were \$96.7 billion, up 6.6%, less than half the HP growth rate.



HP's \$28.3 billion-fourth quarter blew the Wall Street revenue forecasts right out of water, exceeding them by a cool \$1 billion. Even better news for the company's shareholders was that the bottom line surged by double the top line's growth rate. Net earnings were up 28% in the fourth quarter to \$2.2 billion. For the full fiscal year 2007, HP earned \$8 billion, up 17% from the year before.

This means that the biggest IT company in the world has not only gotten bigger in the last 12 months, but also *better*.

HP's stellar fourth quarter performance also means that there is no evidence of a derogatory subprime crisis impact on its business performance. HP sailed unscathed through the troubled waters of the last three months that included the worst of the financial hurricane season so far. Even its financial services unit grew in double digits (up 21%).

"We saw no material weakness in the fourth quarter" (related to the financial services

crisis), CEO Mark Hurd said during the teleconference with analysts.

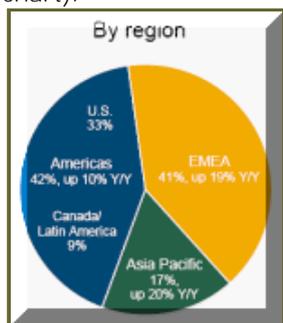
"We do not have a huge exposure to the financial services industry," Hurd reiterated that in an earlier call with reporters. "We saw no change in spending in financial services in the quarter."



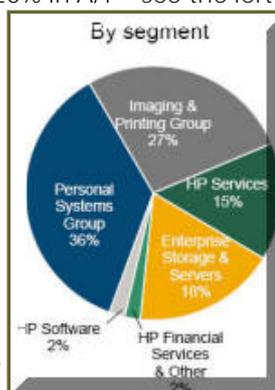
Naturally, statements like that were music to investors' ears, battered by the myriad of bad news, especially on the day the Dow plunged 218 points to close below 13,000 for the first time since August. So HP shares rose over 1.6% in after-hours trading, following the release of its fourth quarter results. The stock had dropped 2.6% in regular day's trading on Monday.

Business Segment Analysis

HP also finished the year in style, displaying balanced performances across its businesses and geographies. HP revenues jumped in double digits in ALL of its global markets (up 10% in the Americas; up 19% in Europe; up 20% in A/P - see the left chart).

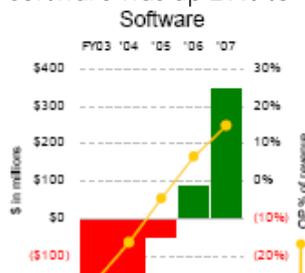


But the most impressive performance was again delivered by the PC unit, and by the emerging markets like China, where the business more than doubled. Overall, revenues in the BRIC countries (Brazil, Russia, India and China) surged by 37% in the fourth quarter. They now account for 9% of HP total. Non-U.S. business now represents two-thirds of the HP worldwide revenues.



Software revenue also exploded, doubling since a year ago to \$698 million in the fourth quarter. The growth was boosted by both the Mercury acquisition and by indigenous growth of OpenView software (up 24%). For the full year, HP software was up 29% to \$2.3 billion.

"I'm particularly pleased with the success of Mercury and the integration has gone well," said CEO Hurd during the post-earnings teleconference. "In the fourth quarter we began to achieve the kind of operating margins expected from a scaled software business (over 25%), one that is



engines, Java)

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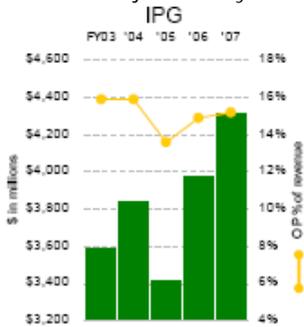
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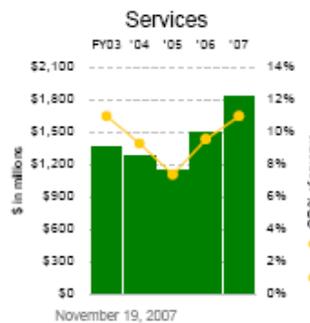
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now the sixth largest software company in the world."

Indeed, you can see from the right chart (above) showing operating profits (in green vs. losses in red) how Hurd completely turned around HP's formerly money-losing software business in just two years.

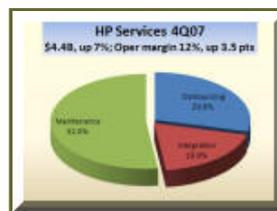


The only relatively mild blemishes in an otherwise outstanding closing quarter of FY07 were single digit increases in the Printing & Imaging (up 4%) and Services in units (up 7%). But they were still increases. There were no declines this quarter. And the



profit margins in both of these operating units improved year-over-year (see above charts).

"For the full year, operating margin expanded 140 basis points to 11% of revenue, highlighting the sustained efforts of the team to reduce the cost of service delivery," Hurd praised the efficiency improvements that the HP Services leaders achieved in the last 12 months during the teleconference with analysts.



Summary & Outlook

Looking ahead to fiscal year 2008, HP sees no signs of its growth slowing down. The company is expecting about a 7% revenue increase to \$111.5 billion, and again a twice as rapid profit improvement (up about 14%) to about \$3.35 per share.

It is clear that HP's focus on consumer markets and the related PC and printer/imaging products has sheltered it from the financial carnage at the high-end of the corporate market where Big Blue tends to hold fort. So until such time that enough blood-letting in the financial sector starts to wane, or IBM changes its strategic tack toward the lower segments of its customer pyramid, HP is likely to continue to gain ground on the former industry leader and on most of the rest of the major IT players.

Our pro-forma analysis of the various HP lines of business shows that the company is currently slightly undervalued in the marketplace (by about \$5 billion, \$133 billion vs. \$138 billion component value - see the chart). But then, so are most other IT stocks at the moment.



Whatever the actual fair market value may be right now, the fact is, HP shares have risen 138% since Mark Hurd took over in April 2005. And that's another measurement of improved business *quality* that supplements the company's title as the largest IT company in the world.

Biggest gets bigger, better... that's HP today.

For a detailed [HP 4Q07 and full year 2007 P&Ls](#), Annex clients [click here](#)

Happy bargain hunting!

Bob Djurdjevic

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Bob Djurdjevic, Editor
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e-mail: annex@djurdjevic.com

8183 E Mountain Spring Rd, Scottsdale, Arizona 85255
Tel/Fax: +1-602-532-7789

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