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ANALYST QUICK NOTES

New products, M&A announcements, management shakeups, earnings surprises. Whatever the news, you want to know what Argus thinks. Our Quick Notes fill this need by providing real-time analysis of current news about Argus-covered companies or other market-moving events. Please check back regularly for new Quick Notes. Important disclaimer information is on the last page of this document.

Hewlett Packard Enterprise Co. (NYSE: HPE: BUY)
Target Price: $19
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Thesis

- HPE is a pure-play on next generation data center and the enterprise customer.
- 2Q16 results showed HPE beginning to navigate disruptive transitions including cloud, big data analytics, software defined data center, and enterprise mobility.
- Sale of the Enterprise Services business to Computer Sciences Corp. reduces the complexity of operations and markets served, helps growth and aids margins.
- But divestiture also makes HPE more of a pure play in hardware – a challenging market amid cloud transition.

Fiscal 2Q16 (ended 4/30/16) Performance

- HPE report fiscal 2Q16 results after hours on Tuesday 5/24/16.
- Revenue of $12.71 billion, non-GAAP EPS of $0.42.
- Street expected: Revenue of $12.34 billion, adjusted EPS of $0.42.
- Argus expected: Revenue of $12.45 billion, adjusted EPS of $0.43.
- Comparisons are against restated data (not comparable with old Hewlett-Packard Inc.).
    - Revenue up 1% y/y.
    - EPS down 1% (from restated $0.44).

Sale of Enterprise Services (ES) to Computer Sciences Corp.

- Enterprise Services unit (37% of total): 2Q16 revenue of $4.7 billion, down about 2%.
    - Both IT Outsourcing nearly flat.
    - Applications & Business Process Outsourcing down 3%.
    - Both continue to adapt to the roll-off of lower-margined business.
- This sale rids HPE of a non-complementary business that has been drag on growth and on margins.
- Meg Whitman noted some companies they want to sell hardware to see ES as a competitor.
- Plus EG has its own support services business (TS & consulting).

Performance of HPE in 2Q16

- Enterprise Group: Revenue of $7.0 billion (55% of total), up about 7% year over year.
  - Mid-single-digit growth in industry standard servers, and better growth in business critical systems (UNIX servers).
  - Mid-single-digit decline in technology services.
  - Networking up sharply following sale of majority stake in Chinese-based networking assets to companies controlled by Tsinghua University.
  - Software (6% of revenue) down in low double-digits.

Strategic Positives

- Sale of Enterprise Services is smart end-game for this business, as HPE is being outgunned by IBM and pure plays (Accenture, Infosys, Cognizant).
- This sale-partnership makes HPE a smaller company ($8 billion/q revenue, $32 billion annual revenue) but better margined and better positioned to grow.
- Enterprise Services is low margined, has not shown topline growth.
- On 12/1/15, HPE announced plans to develop a cloud business with Microsoft, although the initial positive response (a 5% stock rally) was subsequently reversed.

Full-Year Outlook

- For all of fiscal 2016, HPE reaffirmed guidance for non-GAAP EPS in a range of $1.85-$1.95 per diluted share.

Conclusion

- Sale of ES helps HPE on path to faster growth and margin expansion.
- Amid intense cloud competition, no guarantee that a hardware-based company can thrive; but HPE not standing still.
- We think HPE can build on its incumbency and legacy relationships in the data center to create a strong enterprise brand.

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