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BusinessWeek

A NASTY SURPRISE FROM HP Its PC unit is in the red again after six months of profitability

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Abstract (Article Summary)

Hewlett-Packard Co. execs have insisted all year that the company is fast rivaling Dell Inc.'s ultra-efficient, low-cost model for selling computers. But on Aug. 19, some gaping holes were poked in this sanguine claim. Just five days after Dell nailed expectations for its quarterly numbers, HP baffled Wall Street. Its fiscal third-quarter results of \$297 million in net income and \$17.3 billion in sales whiffed analyst estimates on both counts, driving HP's shares down 10%, to \$19.80. Competitive pressure in computers is only going to get more intense. While CEO Carleton S. Fiorina promised in an Aug. 19 conference call to be less aggressive in PC pricing to bolster margins, Dell the next day announced a broad swath of price cuts as large as 22% on PCs and servers. The unspoken taunt is clear: Dell believes it can operate profitably at levels HP cannot.

Full Text (527 words)

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Just five days after Dell nailed expectations for its quarterly numbers, HP baffled Wall Street. Its fiscal third-quarter results of \$297 million in net income and \$17.3 billion in sales whiffed analyst estimates on both counts, driving HP's shares down 10%, to \$19.80. The company stumbled in setting prices too low, particularly in the personal-computer business, and miscalculating demand, both areas where Dell has executed. Result: HP's personal-systems division, including PCs, posted an operating loss of \$56 million after breaking into the black six months prior. HP "should have done better," says CEO Carleton S. Fiorina.

Competitive pressure in computers is only going to get more intense. While Fiorina promised in an Aug. 19

conference call to be less aggressive in PC pricing to bolster margins, Dell the next day announced a broad swath of price cuts as large as 22% on PCs and servers. The unspoken taunt is clear: Dell believes it can operate profitably at levels HP can't. "HP had an opportunity to take advantage of competitors in PCs but ended up doing damage to itself," says analyst Laura Conigliaro of Goldman, Sachs & Co.

That damage isn't just to the bottom line. Analysts also were troubled by HP's inability to manage Wall Street's expectations. In an era where tech companies typically set conservative financial guidance and then make sure to deliver those numbers, HP clipped its credibility. The company's \$100 million top-line miss on analyst estimates was especially startling. HP hadn't provided third-quarter projections, but it had said it was comfortable with analysts' projections for the second half. Now, the company acknowledges that it may fall short of those numbers. "It was generally lackluster," says Bear, Stearns & Co. analyst Andrew J. Neff. "We want to see some consistency."

To deliver steady results, HP will have to solve its execution issues. One key problem was its overly aggressive pricing in desktops, where it sought to undercut Dell. With component prices not falling as expected and HP tied to longer-term deals with retailers and resellers, its margins were squeezed. While Dell has more flexibility because of its largely direct-sales model, HP promises that it will continue to ratchet up its direct business. HP also underestimated demand for flat-panel displays and was forced to air-freight in parts at a much greater cost.

Certainly, some of the company's struggles are seasonal. Its European and consumer operations -- areas that are more significant to HP than to Dell -- generally fade during HP's fiscal third quarter and pick up steam in its fourth. "Some of our drawbacks in the third quarter can be huge advantages in the fourth quarter," says Jeff Clarke, HP's executive vice-president for global operations. But HP has some cleanup to do before it can capitalize on any such benefits.

[Illustration]

Photo: Photograph: CEO Fiorina said HP's PC prices were too aggressive. The next day, Dell slashed its prices
PHOTOGRAPH BY LISA QUINONES/BLACK STAR

Credit: Ben Elgin in San Mateo, Calif.

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