Hewlett Packard Enterprise Reports FY 3Q17 Results: Solid Results as It Completes Divestments
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Financial Announcement Highlights
Hewlett Packard Enterprise (HPE) announced net revenue of $8.2 billion up 3% from the prior-year period as reported (future HPE was up 6% when adjusted for divestitures and currency). Non-GAAP net earnings per share were $0.30, above the previously reported outlook of $0.24 to $0.28 per share. Non-GAAP operating profit from continuing operations was $693 million. The Enterprise Group delivered 75% of the operating profit ($634 million), Software 21% ($179 million), and Financial Services 8% ($70 million). Corporate investments were -4% (-$34 million). Cash flow from operations was $0.9 billion, down 47% from the prior period. In the quarter, HPE returned $732 million to shareholders in the form of stock repurchases and dividends.

As of September 1, HPE completed its previously announced $8.8 billion spin-merge of its software business unit to Micro Focus. HPE sent its Application Delivery Management, Big Data, Enterprise Security, Information Management & Governance, and IT Operations Management to Micro Focus. Micro Focus is based in the United Kingdom and as a function of this transaction becomes a top 10 worldwide software supplier (as ranked by revenue). Former HPE Software Executive Chris Hsu will serve as the CEO of Micro Focus. Earlier in the day, HPE also announced its intention to acquire Boston-based Cloud Technology Partners (CTP) — a company focused on providing consulting services to assist in enterprise customers' migration to hybrid cloud environments.

Geographic Performance
The Americas represented 45% of HPE's revenue in the quarter, down 2% (up 3% when adjusted for currency); EMEA was 34%, up 5% y/y (+7% when adjusted for currency); and the AP region (including Japan) was 21% of revenue, up 10% y/y (+10% when adjusted for currency). For the company, non-U.S. net revenue was 63% of total revenue.

Performance by Business Unit
Enterprise Group revenue was up 3% (+3% when adjusted for currency) y/y to $6.8 billion, with operating profits of $634 billion (9.3% of revenue). Server revenue was down 1% (flat when adjusted for currency). Notably, core compute server revenue (excluding tier 1 sales) grew 12%. Sales to tier 1 service provider customers declined 40% in the quarter (tier 1 customers typically make up 10–15% of HPE's server sales). Blades were up "double digits," we believe on the strength of the HP Synergy product line that has now landed over 600 customers. Storage revenue grew 11% (up 11% after currency), all-flash arrays were up 30% primarily due to the impact of the Nimble acquisition (compared with 70% growth for the same period last year), and 3PAR declined 9% due to a more competitive environment from the likes of Dell and NetApp. Networking was up 16% (+17% adjusted). Aruba products grew 30%. Interestingly, wired switching grew "mid-single digits," indicating that HPE is having success across
multiple parts of its networking portfolio — beyond just Aruba. Technology services were up 1%, (+2% adjusted) and represented 29% of revenue for the Enterprise Group.

Software revenue was down 3% (-2% adjusted) at $718 million for the quarter. Operating profit was $179 million, or 24.9% of revenue. New licensing revenue was up 2% (5% adjusted), and software support revenue was down 2% (down 1% adjusted), while revenue from software services declined 10%, year over year (-22% adjusted). Software-as-a-service (SaaS) revenue was up 7% (up 7% adjusted).

**IDC's Point of View**

HPE delivered a solid quarter. Early returns from cost control efforts and better execution in core parts of the server, networking, and technology services businesses allowed the company to not only demonstrate meaningful revenue growth (for future HPE) but sequential operating margin expansion.

Perhaps most importantly, with the completion of the software business spin-merge, the company completed the "third leg" of its multiyear separation from being a single operating entity into multiple discreet operating companies. With the completion of the software spin-merge, HPE greatly simplifies its product portfolio and the levels of the technology stack in which it participates. HPE is now squarely focused on the infrastructure needs of customers (whether at the core or the edge) and the associated services to support these efforts.

Interestingly, HPE's announcement of the intent to purchase cloud technology partners (CTP) not only augments the company's efforts in the technology services space but makes them more relevant. With the recent spin-merge of HPE's Enterprise Services group to CSC (to form DXC Technologies), it's not uncommon for customers to still express confusion at which segments HPE participates in the services space. While with the recent launch of HPE Pointnext services the story became more clear, it was still limited in terms of future customer needs in the enterprise. In our opinion, enterprise customers are on a journey to modernize infrastructures — not just physical (on-premise) gear but also the move to the cloud. With CTP, Hewlett Packard Enterprise adds the capability to help customers not only move applications to the cloud but build new solutions on the cloud and operate those services at scale. When combined with HPE's January 2017 acquisition of Cloud Cruiser, HPE adds the ability to help customers better monitor and control cloud spending. Clearly, in the services space, HPE is building out its portfolio. As enterprise spending shifts to hybrid environments, customers need partners that can keep current systems running, while transitioning to the right mix of IT — with all options on the table. We believe it is a bid for not only current but future long-term relevance in the space — something sorely needed for the company. The challenge with the strategy will be scale. HPE operates in over 60 countries worldwide; today, CTP is a company of 200 individuals operating primarily across North America and parts of Western Europe. In our view, HPE will need to quickly invest in people and tools to help propagate CTP-trained assets across larger portions of the Pointnext engagement staff and ecosystem. Time is of the essence here, as HPE's customers are moving quickly. HPE needs to prioritize those regions that have the right mix of size and underpenetrated customers to build momentum. The good news is that, while HPE is late to the discussion, this is a long-term customer transformation that will not have a clear end. With this announcement, HPE is participating in a much wider part of the market.

Some of the progress HPE made this quarter is the result of early returns from its HPE Next re-architecting program announced in June 2017. HPE Next is designed not only to rightsize the overhead function in HPE (which had historically a much larger organization) but also to rethink how business is
done within the company. It's clear that the processes and infrastructure of HPE were built for an earlier era of business — and this combined with the radical changes in what make up the operating businesses within HPE underscore the need for change. HPE’s strategic challenge is to go beyond the near-term wins that come from cost cutting and to meaningfully change business processes to support its new, more focused scope of business. Obviously, this needs to include faster decision making, more effective opportunity assessment, and perhaps most important creating a structure and process that can quickly integrate acquired companies (for the transformation of core HPE) without stifling the value originally captured. Recent examples of success in this area are Aruba, SimpliVity, and Nimble, where the core technology, products, and people have been meaningfully redefining for HPE. The company’s stated goal with HPE Next is to enter FY18 with a clean sheet operating model to support the company for years to come.

While many will point to 2017 as a year for divestment for HPE, we also see it as a period where HPE’s long-term strategy has come into much better focus. Over the past 18 months, HPE has worked to modernize (organically and inorganically) its product portfolio in the core enterprise infrastructure market specifically in areas with attractive pools of profit. We believe that this strategy has long-term viability, but it requires a steady cadence of new category expansion. Interestingly, as a smaller company, HPE has reduced the pressure to do “big deals” to drive growth but instead need to steadily execute on smaller near-term accretive deals. This year, we also saw the launch of HPE Pointnext. We believe that, through Pointnext, HPE is putting in place a strategy for how it can engage with customers around the services the help customers leverage emerging, not just legacy, IT.

In our opinion, there was a quarter of progress on multiple fronts for the company. Better execution is required for near-term viability. As a smaller company, if HPE can’t execute in a more consistent manner, then the entire premise for the separations come into question. However, steady execution is not enough. HPE has done a great job of building a product portfolio that’s more relevant to customers that are investing in private cloud and on the edge. Today’s addition of CTP to the Pointnext portfolio makes them more relevant for customers that are migrating workloads to the cloud. HPE is acknowledging that this is where customers are going and is executing strategy to be relevant in this customer journey and destination. Building on this strategy will ensure that long-term HPE has a more complete role in customers’ future IT needs.

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