HP Inc.

Q4 2016 Earnings Conference Call

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CORPORATE PARTICIPANTS

Dion Weisler - *President and Chief Executive Officer*

Cathie Lesjak - *Chief Financial Officer*

Diana Sroka - *Head of Investor Relations*

PRESENTATION

Operator
Good afternoon and welcome to the Fourth Quarter 2016 HP Inc. Earnings Conference Call. My name is Amy and I'll be your conference moderator for today's call. At this time, all participants will be in listen-only mode. We will be facilitating a question and answer session towards the end of the conference. Should you need assistance during the call, please signal a conference specialist by pressing the "*" key followed by "0." As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the presentation over to your host for today's call, Diana Sroka, Head of Investor Relations. Please proceed.

Diana Sroka
Good afternoon. I am Diana Sroka, Head of Investor Relations for HP Inc. and I'd like to welcome you to the fiscal 2016 fourth quarter earnings conference call with Dion Weisler, HP's President and Chief Executive Officer, and Cathie Lesjak, HP's Chief Financial Officer. Before handing the call over to Dion, let me remind you that this call is being webcast.

A replay of the webcast will be made available shortly after the call for approximately one year. We posted the earnings release and the accompanying slide presentation on our Investor Relations webpage at www.hp.com. As always, elements of this presentation are forward-looking, and are based on our best view of the world and our businesses as we see them today. For more detailed information, please see disclaimers in the earnings materials relating to forward-looking statements that involve risks, uncertainties and assumptions.

For a discussion of some of these risks, uncertainties and assumptions, please refer to HP's SEC reports, including our most recent Form 10-K and Form 10-Q. HP assumes no obligation and does not intend to update any such forward-looking statements. We also note that the financial information discussed on this call reflects estimates based on information available at this time, and could differ materially from the amounts ultimately reported in HP's Form 10-K for the fiscal quarter ended October 31, 2016.

For financial information that has been expressed on a non-GAAP basis, we've included reconciliations to the comparable GAAP information. Please refer to the tables and slide presentation accompanying today's earnings release.

And now, I will hand it over to Dion.

Dion Weisler
Thank you, Diana. Good afternoon, everyone, and thank you for joining us today. I'm pleased to announce another quarter of solid progress in both innovation and execution. As we wrap up our first fiscal year as HP Inc., we continue to deliver on our financial commitments and I am proud of the progress we are making in our core, growth, and future framework.

In Q4, we delivered non-GAAP diluted net earnings per share of $0.36; within our outlook range, and we achieved net revenue growth normally and in constant currency. For the full-year, we delivered non-GAAP diluted net earnings per share of $1.60; within the original outlook range provided at the start of the year. We exceeded expectations for free cash flow delivering $2.8 billion and returned over $2 billion to shareholders; at the high end of our 50% to 75% target range.

This time last year, we faced industry-wide headwinds and difficult market conditions, but as I said to you then, we believe change equals opportunity and that we would reinvent ourselves and our business to drive long term success. We accelerated restructuring activities and adjusted our tactics to deliver on our commitments with operational discipline. What's notable is we did this while maintaining key investments in innovation to help us drive long term profitable growth. And what you have seen during the course of the year are perhaps the most competitive and disruptive products ever. While the road ahead will continue to be challenged, we exited fiscal '16 with momentum and confidence in our ability to execute.

Before we provide our view on Q1 of '17, I want to spend a few minutes on some of this quarter's highlights and achievements in Personal Systems, Printing and 3D Printing. Personal Systems delivered the trifecta once again with year-over-year and sequential revenue growth, market share gains, and increased operating profit.

Coming into the quarter, we anticipated component shortages and took actions that positioned us well to take advantage of profitable growth opportunities. We have a robust innovation engine producing an incredibly strong portfolio across consumer, commercial, notebooks, desktops, workstations and services. Each delivered top line growth despite an overall tough and competitive market.

Through discipline and focus, we achieved share gains across all three regions yielding a record high position of 21.4% market share worldwide. We are outperforming both the market as a whole and the competition. In line with our core strategy, we focused on highly segmented profitable opportunities where we chose to play. We continued momentum in the consumer premium and gaming segments enabling us to beat consuming notebook market growth by more than 10 points.

In commercial, we achieved another record high share position of 24.8% with accelerated growth in higher margin offerings including Care Packs and other commercial services. We continue to play our own game in Personal Systems and are seeing traction as we deliver differentiated experiences that amaze.

One of the product highlights for the quarter was the delivery of our high-end OMEN X gaming platform for those who crave a truly immersive experience. We also introduced the world's first notebook with an integrated privacy screen to combat visual hacking and extend our leadership in security.

We also launched the Pavilion Wave and Elite Slice PCs. These systems combine engineering excellence and truly inventive desktop design. We are setting the standard for highly innovative and beautiful devices taking profitable market share and forcing our competitors to raise their bar if they want to compete for the hearts and minds of premium customers.

Shifting to printing, for the first time in several quarters, print hardware revenue grew year-over-year with units up 1% as compared to declines of 20% in Q1, 16% in Q2, and 10% in Q3. In addition, we improved ASPs both year-over-year and sequentially. Towards the end of Q4, we saw some pockets of improved competitive dynamics that we associate with the strength of the yen.

We will continue to be disciplined in our hardware unit pricing with a focus on shifting the sales mix towards units that deliver higher value over their lifetime. In Q4, we continue to execute the supplies sales model change that we announced in Q3 which is helping us to achieve more consistent global pricing. As a result of these actions, we exited the second half with a significant reduction in supplies channel inventory in line with our outlook.

We are now well positioned as we enter fiscal 2017, and will continue to increase marketing spend to drive HP original supplies brand awareness and end user demand. We remain confident that shifting to a replenishment channel fulfillment model is a much more efficient way to run our global go-to-market strategy for supplies in the new omni-channel reality.

While we continue to work on improvements in the core print business, we also achieved progress in our growth initiatives. Graphics delivered a record revenue quarter coming off a successful drupa show, with constant currency growth for the 13th consecutive quarter.

In fact, in Q4, we delivered more than 300 HP Indigo digital presses, following a robust order pipeline. Companies like Shutterfly and Simpress are now taking full advantage of the benefits of digital over analog, as well as the quality and productivity breakthroughs enabled by our presses to address peak holiday season demand.

Managed print services had another excellent quarter with double-digit new total contract value growth. This is an area where we significantly outperformed the market and similarly I'm pleased with the adoption of instant ink, our consumer subscription service which continued to increase with a record quarter of new enrollees.

Earlier this quarter, at our annual global partner conference, we announced our acquisition of Samsung's printing business, which will help us accelerate the disruption of the $55 billion A3 copier segment. We expect the transaction to close in the second half of 2017.

In parallel to our announcement, we launched a breakthrough portfolio of A3 multifunction printers and services which will begin to ship in the second quarter. These announcements are symbolic of delivering on the growth portion of our strategy and highlight our commitment to disrupt markets where we can grow profitably.

In support of our more than 250,000 channel partners, we also introduced Partner First program updates that we expect will radically simplify and enhance partner engagement. And in line with the market shift to contractual sales, we introduced device as a service partner specialization to drive services led sales transformation.

As part of our channel strategy and partner centric approach, we were honored recently by Canalys, who named HP number one in EMEA channel satisfaction. This is the first time a large company has ever been number one. This is unprecedented and tells me we are on the right track and investing in our partners to help grow our mutual businesses.

In support of our future strategy in 3D printing, Materialise, a leader in additive manufacturing and 3D printing is adding HP's Jet Fusion 3D printer to its broad suite of technologies. Several HP co-development partners including Materialise, Jabil and Shapeways will receive their first installations of the Jet Fusion 3D printer in the next two weeks.

Along with product installations, HP materials innovation is gaining momentum with leaders like BASF, who has announced a commitment to the HP open materials program, and Evonik Industries who will introduce what they expect to be the first certified material to emerge from our platform in 2017.

While I've highlighted the achievements of the quarter, our core markets are still in flux and we believe the change will only accelerate. The macroeconomic and financial market conditions are uncertain, the US dollar has been strengthening and this trend creates pressures for U.S.-based multinational companies like HP with over 60% of revenue outside of the U.S.

We know how to operate in up and down markets and we are prepared to tackle the challenges that lie ahead and make the right decisions for the company for the long term. We have the right strategy entering fiscal '17 and continue to show we can deliver financial results and momentum on all parts of that business. We are setting this company up for long-term success and I'm convinced our best years are ahead of us.

I will now ask Cathie to provide incremental detail on the financials as well as our outlook for fiscal Q1 of ‘17.

Cathie Lesjak
Thanks, Dion. Overall, I am pleased with our strong finish to the fiscal year. We delivered net revenue of $12.5 billion, up 2% year-over-year as reported or up 4% in constant currency. We expected revenue declines would moderate in the back half of the year and in Q4, we saw revenue growth in EMEA and APJ, both sequentially and year-over-year.

Gross margin of 18.3% was down 1 point year-over-year, due primarily to business segment mix partially offset by Personal Systems rate improvements. Gross margin was flat sequentially with print rate improvements offsetting unfavorable segment mix.

Non-GAAP operating expenses of $1.4 billion were down 8% year-over-year, driven by reductions in SG&A, primarily due to corporate governance and other overhead costs related to Hewlett-Packard Company included in the prior year period combined with non-revenue generating cost savings.

These reductions in SG&A were only partially offset by a deliberate 13% increase in R&D, supporting incremental investments in A3 and 3D printing. For the year, we achieved productivity and restructuring savings which well exceeded $1 billion. With the net expense of $88 million in OI&E, our non-GAAP tax rate of 21.5% and a diluted share count of approximately 1.7 billion shares, we delivered non-GAAP diluted net earnings per share of $0.36.

Non-GAAP diluted net earnings per share primarily excludes net of tax, defined benefit plan settlement expense of $117 million and restructuring and other charges of $36 million, partially offset by net tax indemnification credit of $38 million and non-operating retirement related credits of $19 million.

As we noted on the last two earnings calls, the tax indemnification changes relate to the tax matters agreement with Hewlett-Packard Enterprise Company. We expect that certain tax matters and the related indemnification effect will continue to change each quarter and will be excluded from non-GAAP results.

In Q4, GAAP diluted net earnings per share from continuing operations was $0.30, above the previously provided outlook range due to lower than expected restructuring charges and the net tax indemnification credits.

Turning to the segments, Personal Systems delivered solid performance across all metrics. Net revenue was $8 billion, up 4% year-over-year as reported or up 5% in constant currency. Units were up 5% year-over-year with growth in notebooks, desktops and workstations. Performance was also balanced across the customer segments with consumer and commercial revenue growth of 7% and 3% year-over-year respectively.

As Dion said, we outperformed the market and key competitors in the third calendar quarter. I'm pleased not only with the top line strength, but also with the focus on profitable share gains. Personal Systems operating profit was 4.3%, up 0.6 points year-over-year due to scale, operational cost savings and a focus on higher margin units. Much like last quarter, we saw continued revenue momentum in strategic areas including consumer premium, gaming, commercial mobility and services.

On a year-over-year basis, Personal Systems ASPs were down slightly due to an increase in low end mix and competitive pricing in commercial partially offset by favorable pricing in consumer. Sequentially, ASPs were down due to normal seasonality associated with consumer holiday sell-in partially offset by better mix within commercial and strong attach.

Now turning to printing, while revenue declines continued, we saw progress in all areas of focus. Net revenue was $4.6 billion, down 8% year-over-year as reported or down 6% in constant currency. Starting with hardware, units were up 1% year-over-year, a continued improvement in the trajectory as we've seen throughout the year. We achieved sequential share gains of 0.4 points in laser and 1 point in ink hardware as the progress we made on our cost structure is creating incremental positive NPV units. We continued to improve the quality of our installed base with commercial units up 10% year-over-year.

ASPs were up year-over-year and sequentially, driven by both mix and pricing discipline. In Q4, supplies revenue was down 12% year-over-year as reported, or down 10% in constant currency. The supply sales model change contributed about 7 points of the year-over-year decline, similar to the impact in Q3.

The four-box model drivers caused a 3 point to 4 point year-over-year decline in revenue in constant currency. Supplies revenue mix was 62%, down 3 points year-over-year. About 2 points of the decline can be attributed to the supplies model change that we executed during the quarter. As a result of this supplies model transition; we exited the second half where we expected to be, with a significant reduction in both weeks and dollars of the channel inventory.

Operating profit for printing was 14%, down 2.9 points year-over-year related primarily to the reduction in Supplies revenue. Unlike Q3, we did not have material gains from the sale of software assets to offset the reduction of channel inventory associated with our supplies model change.

We had an unfavorable mix of supplies combined with incremental R&D spend to support A3 and 3D printing, which remain key long term growth drivers. These investments were partially offset by strong operational improvements across the business. And in restructuring, we achieved our accelerated plan as announced at the start of the fiscal year and with lower charges than expected.

Turning to cash flow and capital allocation, cash flow from operations was $698 million and free cash flow was $558 million. The cash conversion cycle was negative 29 days, flat sequentially and down 10 days year-over-year.

On a sequential basis, days of inventory were up two days offset by a two-day improvement in accounts payable as a result of the strategic use of our balance sheet including increased sea shipments and component purchases for the assurance of supply given the tight supply environment that we talked about last quarter. During the quarter, we had total capital return of $214 million primarily through cash dividends. For the full year, we returned 72% of free cash flow to shareholders, at the high end of our original 50% to 75% target range.

Looking ahead, we've assumed the following in our financial outlook. In Personal Systems, we anticipate component shortages to continue and have an impact on profitability in the short term. Supplies revenue growth in constant currency is still expected to stabilize by the end of '17, but the trajectory will not be linear given the unit placement trajectory in fiscal '16.

In Q1, we expect the four-boxes in our model to drive a mid single-digit decline pressuring total company revenue growth and profit. For the full year, we have assumed we will deliver on our additional productivity initiatives and restructuring activities as announced at SAM, which we expect will drive improved profitability over the course of the year.

And more broadly, we expect continued macroeconomic uncertainty that could impact market sizing and competitive dynamics, especially related to unfavorable currency moves. A significant deterioration could have a material impact on revenue and profit, especially in supplies, given its tight correlation to gross domestic product growth.

Note also, that our outlook assumes currency rates as of the end of October. With all that in mind, our Q1 2017 non-GAAP diluted net earnings per share is in the range of $0.35 to $0.38. Q1 2017 GAAP diluted net earnings per share from continuing operations is in the range of $0.33 to $0.36.

Our full year fiscal 2017 non-GAAP diluted net earnings per share remains in the range of a $1.55 to $1.65 and our full year fiscal 2017 GAAP diluted net earnings per share from continuing operations remains in the range of $1.47 to a $1.57.

With that, let's open it up for questions.

Q&A

Operator
We will now begin the question and answer session. To ask a question, you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pickup your handset before pressing the keys, to withdraw your question, please press "*" then "2." We also request that you only ask one question.

The first question is from Jim Suva at Citi.

Jim Suva
Thank you very much. You did very well in the PC segment and previously you've made some comments about using your balance sheet to procure components and it turns out that ended up being a very wise decision. Can you help us understand two things? First of all, are you continuing to do so and if so, how long do you think you'll continue to do so or have the need to? And second of all, with the shortages of supply and ability to get the components, how come your gross margins for PCs were not stronger quarter-over-quarter, as the revenues grew

considerably quarter-over-quarter, but operating margins didn't. Did you reinvest some of the money or how should we think about that? Thank you.

Dion Weisler
Great, thanks Jim. Let me say broadly speaking that the basket of components that make up a PC, there are some components in there, that are in ready supply, there are other components that are in tighter supplies we alluded to on the last call and indeed we did say we would leverage the balance sheet to go off and ensure that we procured, that is one of the changes that I have often talked about and a common theme that we have in the business to take that change and turn it into opportunity. I think the team executed really well in the course of Q4 against that backdrop. I think the team did trifecta squared last quarter, they grew revenue margin and share, and they did it again this quarter. And I was pleased with their performance, specifically on the margin rates. I will let Cathie chime in.

Cathie Lesjak
Sure. Thanks Jim. In terms of the margin rates, it was competitive pricing on a sequential basis, but also normal seasonality because we are really talking about the kind of the sell in for the holiday period of time and that tends to have a higher consumer mix. We did see ASPs basically up in commercial on a sequential basis, but again normal seasonality drove ASPs down for consumer.

Operator
Next question is from Kulbinder Garcha of Credit Suisse.

Kulbinder Garcha
Thanks and just a clarification from me. On the supply side, Cathie, you said it's not going to be linear, which is what you said before, I think. But when I look at this quarter if you back out the seven points on growth in supplies from the inventory drawdown, and there is probably some currency impact in there as well. The Supplies business is probably down low single-digit, you are quite close to getting back to stability. Is there a reason why, let's say in the first half of the year that it could get worse before it gets better. If you can explain some of those dynamics, maybe it's comps maybe it's how you're placing units right now. Anything along those lines, as we think about the next few quarters before you hit that more stable point by the end of 2017 would be helpful. Thanks.

Cathie Lesjak
Sure, Kulbinder. The four box drivers actually had a decline in constant currency for the quarter in minus 3% to minus 4%. So when you make all of the adjustments that you need to make to get to that and that's pretty consistent with the last three quarters. Okay so I think that's the way to think about it. I think it's also important, if I could add a point here and that's just that we use the model to determine what we think is going to happen in the quarter, as well as what we think is going to happen over time. And we were operating pretty much in-line with what we had expected so the quarter came in, in line. For next quarter, we are calling for a mid single-digit decline, and that's really due to how we were placing units.

If you go back to last year, in Q1, we were down 20% in terms of unit placements. In Q2, we were down 16%, you know, kind of, Q2 to Q3, Q3 to Q4 we started to grow sequentially, and in fact from Q3 to Q4 we grew sequentially units about 10% this quarter. And so, we are starting to get an improvement frankly in the absolute level of the installed base. That's one of the boxes in the four box model, and that's putting some pressure on…early on in FY17. And so, it's really more the back half. But the way I think about how you all can get comfortable believing and having confidence that we are going to stabilize the supplies revenue by the end of '17 in constant currency, is really because we are reporting out with the model set we would do at the beginning and how we are reporting at beginning of the quarter and we are reporting at how well we did relative to that. So far, the model has been pretty predictive and certainly over a longer history it has been very predictive. We feel good about the progress that we are making.

Kulbinder Garcha
Thank you.

Operator
The next question is from Katy Huberty of Morgan Stanley.

Katy Huberty
Yes, thank you. How does the return to growth in printer units impact the four box model and your confidence exiting the year with flat supplies? And then just a follow-up, you had talked at the analyst day about potentially reducing printer hardware channel inventory during fiscal ‘17. Is that something you still expect to happen and is the impact baked into guidance? Thank you.

Dion Weisler
So in terms of the units, Katy, what we talked about almost this time last year was the fact that we expect the overall environment to continue to be challenging. As a result of that we would need to consider this the new normal. And we went to work on taking costs out of the business, so that we could turn negative NPV units into positive NPV units and expand the TAM, and through the course of the year that bridge that Cathie just walked you through negative 20% in quarter one, negative 16% in quarter two, negative 10% in quarter three, plus 1% in quarter four was a plan that we began executing after the Q1's earnings call.

And so, we have built that into our model, and our model is therefore predicting that we will indeed return to stabilization by the end of 2017 in constant currency. So it's running according to plan, but it's not just the units, as we've often talked about, it’s the quality of the units. Our Managed Print services had another very strong quarter from a TCV perspective, as did our graphics business, 13th consecutive growth quarter in constant currency. Instant Ink, which is an important initiative for the home-based business, had strong enrollees yet again. And so, many of the dimensions that we have talked about, not just the unit placement, but the quality of the units is operating according to our outlook.

Cathie Lesjak
And Katy, to the second part of your question about whether or not we have made a change to the sales model for hardware as we have done for the supplies within print. The answer is that our outlook today as is the same as SAM, it does not include a change in that go to market model. We are still analyzing whether or not we want to do that and what it would take to do.

Operator
The next question comes from Toni Sacconaghi of Bernstein.

Toni Sacconaghi
Yes, thank you. I am wondering if you could comment on the planned marketing investments and demand stimulization investments that you were planning for Q4, and whether you made them at the level that you thought and whether you got the acceleration in units that you thought? The reason I ask is, it looks like printer hardware sort of improved with normal seasonality in Q4, and certainly the way you talked about it last quarter was that your demand

stimulation efforts would yield something significantly higher than that. So I am wondering if you can comment, did you invest what you expected to invest and did you get the kind of demand stimulation that you thought? And then I am still struggling with, how you can be looking at supplies growth being so weak in Q1, given that your comparison is so easy and your supplies is a function of your last three to six years worth of sales, and so you shipped $100 million less in each of Q1 and Q2 in hardware. I don't know how that can mathematically translate into a deceleration against an extra comp on supplies growth going forward. Is there anything else there in terms of your plan to take down further inventory or anything else happening in the channel that might explain that because the math doesn't seem to work.

Cathie Lesjak
So let me start with the first question around marketing. So yes, we did execute on our marketing plans in Q4 and just to be clear, our marketing plans related to the supplies change that we were making is really not about stimulating demand at the hardware level, it's really about stimulating demand for HP branded supplies. So it's about awareness…and building awareness and brand preference and print relevance. So helping people understand why they should want to print and we did execute on that. The unit acceleration was actually in ahead of what is normal seasonality for us. So, sequentially we grew units 10%, and our normal sequential is kind of 7% to 8%, so we are feeling good about the progress that we've made. We did get acceleration on the hardware side.

In terms of your second question around supplies growth, why is it that weak in Q1? At this point in time, when we put through all of the different variables and all of the assumptions that we've got within our model, we are calling for a mid single-digit decline in supplies and constant currency on a year-over-year basis in Q1. And with that, the model is still basically supporting the forecast that revenue…Supplies revenue and constant currency will stabilize by the end of 2017.

Operator
The next question is from Rod Hall at JP Morgan.

Rod Hall
Hi, thanks for taking the question. I wanted to go back to the printing business and the margins. Margins dropped off more than we thought that they would in the quarter, and we see this unit number stabilization or little bit better than we thought it would be. So I'm just curious how you would expect that margin to track through the beginning of the year, especially given the yen strength. Because it seems like if you guys want to achieve your goals in supplies, you need to keep placing these units. If the yen continues to weaken, then you may find that more difficult to do. So I just wanted to check that in light of the currency movements.

Cathie Lesjak
Sure. There are actually a few different questions in there so let me see if I can hit them. The first one in terms of the OP rate of 14% in Q4 that was in fact very much in line with what we had expected and what we talked about on the Q3 earnings call. And the reason it is off…significantly off of Q3, which was 20.4% is really the result of the last stage…the last quarter of the supply sales model transition that we were going through, without having the compensating software divestiture gains. Those all showed up in Q3. At the same time that…roughly half of the plan was for Supplies transition was going through. So if you actually normalize over the year, the OP rate for print was in line with what we've seen in the past, mid-teens at 17%. So, I don't think there are any big surprises there and that 14% is consistent with

what we said on the Q3 earnings call. We had in our own forecast, the fact that we were going to place these incremental units already.

In terms of your question about Japanese competitors and the foreign exchange environment, I have to tell you it's a little bit hard to answer that one with clarity and let me explain why. First, I think it’s a very uncertain macroeconomic environment. And it’s hard to know what’s going to happen on a go-forward basis and from the U.S. administration, what kind of policies are going to be put in place and what the impacts are going to have on currencies. And then it’s even more complicated because in many ways we didn’t see broad-based kind of relaxation on aggressive pricing from the Japanese competitors, when the yen was stronger. Now that it’s weakened a bit in the last few weeks, it’s unclear whether or not they are going to be more aggressive or this is just an opportunity for them to hold the pricing that they’ve had all along, it’s just not clear. What is clear to us is that in our outlook for FY ‘17, we have assumed no change in the pricing environment. So we haven’t assumed that even though the yen is a bit stronger relative to '16, we have not assumed that the Japanese ease up on pricing nor have we assumed that they get more aggressive.

Operator
The next question is from Sherri Scribner at Deutsche Bank.

Sherri Scribner
Hi, thanks. I was hoping to get a little more detail on the strength in the PC business, the linearity in the quarter and also how sustainable is that strength into next quarter as well as further out. Thanks.

Dion Weisler
Thanks, Sherri. So I would say that the PC market is operating as we expected it to, I still think there is uncertainty in the market, the market as a whole hasn’t returned to growth. At the beginning of the year, we expected the declines would moderate through the course of 2016 and they did, and we were able to adjust to that market, I think, much more quickly than many of our competitors. As a benefit of being a separated company, the speed, flexibility, focus of the organization was able to react to these market conditions and as a result of that, we’ve performed significantly better than the market and taken a solid premium portfolio to market. I think longer-term, the business will continue to evolve and develop as a very large continuum of devices, everything from a smartphone all the way up to Workstations, some of that market we participate in, not all of that market, but the lines are blurring between the different categories within that spectrum. And indeed, categories are being created in the X3; Elite X3 is a great example of a device that bridges a PC and a laptop.

So I would characterize as the market is changing, we are ahead of that curve, we are skating towards where we believe the puck is going and investing in the heat of the market that we find particularly attractive. I think the team did a great job in our gaming platform, in the premium segment, in commercial mobility, whether it would be X2 or X3. And we are unlocking parts of the market that we are still attracted by. Let's remember it’s a $320 billion TAM and about half of that, things like services, displays, accessories that we have lower market share and team is expanding our business there. So we still think there is great opportunity within the Personal Systems environment, it’s a changing market landscape. It has improved from the beginning of last year and we don’t broadly disagree with the outlook from the analysts, but I think what you can expect us to do is continue to deliver ahead of the market.

Cathie Lesjak
You also asked a question about linearity in the quarter. The linearity in the quarter was normal, so there was nothing particular to call out, it was normal historical linearity.

Operator
The next question is from Shannon Cross at Cross Research.

Shannon Cross
Thank you very much. Dion, can you talk a bit about what you are thinking with regard to A3. You've announced the Samsung acquisition a couple of months ago, and had some time to digest it. So I'm curious as to what you are hearing from your channel partners, if there's been any change to how you are thinking about the approach, relationships with Canon, what you are planning with Samsung's printers, just if you could give us a bit more color. Thank you.

Dion Weisler
Sure, I would say Shannon that the integration is running according to our timeline. We expect it to close within nine-to-12 months from the original announcement date. The team is on the ground, working very closely with the Samsung counterparts to get this done. We continue to be incredibly impressed with the quality and caliber of the people, as well as the technology. Samsung represents more than 10% of South Korea's total GDP and they attract the very best talent in the entire country and having that group of high-caliber engineers and other folks joining our company is impressive.

The 6,500 patents are very high-quality patents as we continue to work through that and it gives us the opportunity to disrupt this $55 billion market. So that's on the Samsung side. We've been running a separate track through the course of 2016 as we were looking to aggressively enter the A3 market on the go-to-market side of things and I have travelled all around the world, met with the largest A3 channel partners, many of which are not channel partners for HP today, some of which are, the Venn diagram is not mutually exclusive here.

And I think we've made tremendous progress. We've shared with them the value proposition of working with HP and our disruption in this space and we have an incredible amount of interest across the globe from these go-to-market partners as we begin to unlock and even begin quoting on opportunities that we expect to deliver on as we launch the products in the April timeframe.

Operator
The next question comes from Simona Jankowski at Goldman Sachs.

Simona Jankowski
Hi, thank you. Cathie, I think you began to touch on this, but I would love to hear more of your takeaways on the potential implications of the U.S. election, in particular as it pertains to the potential changes to the tax code as well as tariffs.

Cathie Lesjak
Simona, it's really too early to have a strong opinion on all of the different proposals that are out there, because there are so many and it's unclear at this point in time exactly what the situation is going to be and how it might impact on HP and what actions HP might take as a result of those policy changes.

Dion Weisler
I would add that we obviously support comprehensive tax reform that makes us more globally competitive. We support multinationals having fair access to overseas markets and the flexibility to operate global supply chains. But I think Cathie is quite right, it's very early days. We operate in 170 countries around the world, and our mission here is to deliver experiences that amaze and we want to be able to do that in an environment…in an appropriate tax environment and in an appropriate global environment.

Operator
The next question is from Maynard Um at Wells Fargo.

Maynard Um
Thanks. Can you clarify whether your guidance includes any real estate sale gains from your San Diego campus? And then for the question, can you talk about PC channel inventory out there and whether you think there's a risk of greater than seasonal decline into the calendar first quarter given the relative strength we've been seeing. Thanks.

Cathie Lesjak
Sorry, I didn't catch that last one. You were talking about PC channel inventory levels?

Maynard Um
Right, PC channel inventory and whether you thought there was greater risk going into Q1 given the relative strength we've been seeing recently.

Dion Weisler
So I think PC channel inventory from an HP perspective is well under control and within our ranges and of course, you all know my view on the profile of the inventory, not just the absolute amount of inventory, but the aged element of the inventory is also well under control. This is a situation where I think it's incredibly important to maintain the momentum inside this business. Given we are operating now in a different environment than we have been for many years where we've had an oversupply. We are in an environment now where there is more of an undersupply, so as a result of that, I think overall channel inventory levels across the board are lower than they have been, let's say, this time last year.

Cathie Lesjak
And in terms of your question about the San Diego sale, we don't typically go into that level of detail. If at any time a transaction is material enough then we will call it out.

Operator
The next question is from Steve Milunovich of UBS.

Steve Milunovich
Thank you. I just wondered relative to the analyst day, if there are any material changes in either the EPS or free cash flow bridges that you provided. And in particular, I wanted to ask about the productivity improvements which I think were tagged at $0.43 to $0.47 for fiscal '17. Could you be a bit specific about where those are coming from and your confidence level in achieving those?

Cathie Lesjak
Sure. In terms of the EPS bridge and the cash flow bridge, the answer is no. There is no material change to them. If you want more follow-up on that, I will let you give a follow-up in a

minute. On the productivity side of the house, there is not a single silver bullet or a lever to pull, it is really going to be across a number of dimensions. And it's all the things that we've been talking about in '16, that frankly have opportunity in '17 as well, you know, simplification of our portfolio. Really focusing on the bond costs and making sure that every interconnector is exactly what we need, constantly reengineering products, at the same time we are simplifying our portfolio. We are also doing process reengineering and we are doing process reengineering in finance. We are doing it in sales ops; we are doing it in legal. We are doing it everywhere in the company and technology enables us to take new processes and automate pieces of those processes. And so we are looking at that basically across the company and my view is that's probably never done. There was always new technology coming out that helps you improve a process from an efficiency perspective, and then also just broadly staying completely focused on reducing non-revenue generating costs everywhere we need to do that. And I think there are opportunities in warranty we've seen, there are opportunities and making sure that the discounts that we are giving are giving us the appropriate return. It's all of these items and they are probably the same list of items that I would have given you a year ago. There is just more to do and there is always more cost that we need to stay focused on taking out.

Steve Milunovich
That's great. Maybe I would ask if…what PS and printer operating margins are implied by your full year EPS guidance?

Cathie Lesjak
We don't break them out specifically, but the way we think about Personal Systems is that it's roughly a 3% to 4% operating margin business. Now, there are quarters in which it's higher than that, and there are quarters when it's a little bit lower than that. But that's kind of how we think about the rate of the business.

Dion Weisler
We also think about absolute dollars more importantly.

Cathie Lesjak
Yes I was going to add that. And the big scheme of things what we are really focused on is operating profit dollars. So if there is some low end skews where we can scrape out some gross margin dollars, but it will dilute the rate, we still do it. We are focused on profitable growth and profitable growth is designed to be basically dropping dollars to the bottom line, but we think it was 3% to 4%. On print side of the house, we've seen in '16 kind of mid-teens, if you go back a few years it's generally been in the mid-teen space and we would expect that, that would be true in '17 as well.

Dion Weisler
And from an entire business perspective we've always said for the long-term, we expect this to be in the 8% to 10% range.

Cathie Lesjak
And if I can put a plug in here for the print business… If there is an opportunity because of the cost structure actions that we've taken that we actually create a significantly bigger pool of NPV positive units that we can go after. The team knows that we will drop below the mid-teens. What's important is setting up, making the right investments every day in that business and setting this business up to maximize the area under the curve, right now our range is kind of mid-teens.

Operator
The next question is from Amit Daryanani from RBC Capital Markets.

Irvin Liu
Hi, this is Irvin Liu calling in for Amit. As it relates to your supply channel inventory actions, I know it's still early but can you talk about if you have seen these actions contribute to progress toward a more stabilized supplies pricing environment. And if so, how does that compare with your internal expectations?

Dion Weisler
I would say broadly speaking the shift from push-to-pull is operating according to our expectations. I think we have much less product on promotion than we had in the past and seen a more stabilized pricing environment, in an Omni-channel world that is incredibly sensitive to large fluctuations in end user pricing. So that was the desired affect I think we've seen significantly lower grade marketing from region-to-region. That was also one of the key design points. So still very early days, but the signals, the right signals and the model is operating according to how we expected it to operate.

Cathie Lesjak
To add to that, we feel that we've successfully executed over the last couple of quarters and that we are now making changes to operational metrics and how we drive that business because of the new environment, we specifically have reduced our channel inventory target ranges and narrowed them, and we exited Q4, if we had applied those same ranges in Q4 '16, we would be within those ranges. So we feel really good about the progress there. And the other thing is that we are hearing from our channel partners that they believe this was the right thing to do that given the Omni-channel realities that they have to deal with and we have to deal with, so these actions were the right things to do.

Dion Weisler
Completely on question regarding support from the channel partners.

Operator
The last question is from James Kisner at Jefferies.

James Kisner
Yes, thank you for taking my questions. I am going to drill down on the desktop unit strength. I don't think you talked about this in the call. But this is the first unit growth quarter we've seen in eight quarters. Wondering what the dynamics are there, whether there were promotions happening, are you seeing a turn in the desktop market, any particular models driving that? Just any color on that would be helpful. Thanks.

Dion Weisler
Yes, we are really pleased. I mean, of course notebooks had another really strong quarter of growth units up 9%, but it was great to see a desktop revenue grow 2%, units up 1% year-over-year. No magic here, just really hard work. The team went to work actually midway through '15 and began redesigning the entire supply chain to take costs out, redesigning the entire line up. I think we've got some incredibly innovative products here that are really resonating with customers. They are now in the right price function value equation and when you get that right, when you do the segmentation and you get the cost right and there is value then you end up with a better result and that's what we are seeing with the performance of the desktop business.

James Kisner
Do you think the market is also doing better, is it you outperforming, are we seeing an inflection in the market also? Thanks.

Dion Weisler
Well, I would say broadly speaking…depends what your relative point is, if you look at this time last year, the market is doing a lot better than it was a year ago, and it was…if I recall correctly, it was double-digit negative, it is like negative 12%, and we are in sort of mid single-digits now. We are executing better than the market at a significant premium and we are getting upside as a result of that.

So thank you for those questions. I know it is late on the eve before many of you are going to take off here for Thanksgiving. I do want to close off with saying, I was really proud of what the team did in Q4 and how we have rounded out the year. I think we're entering FY17 on an upward momentum trajectory and that's a very different position than this time last year, as you'll recall. I think there is a lot of change going on within the industry, within the macroeconomic environment but we are adapting to that change and we are turning it into opportunity. We know how to operate in both up and down markets. We believe that this was going to be the new normal and we set ourselves up from a cost position to be leaner athletes as we enter this environment.

And as I think through the course of last year, we were able to demonstrate quarter-after-quarter that we would do what we said we would do, and I feel proud about that. I think we are entering '17 with the right strategy, executing on core, growth and future and leading in the market where we choose to play, not chasing share-for-share sake, but profitable growth is very important to us and stabilizing supplies by the end of '17 in constant currency is also incredibly important to us, and for all of our investors as well. I have great confidence in HP, and I am really convinced that the best years lie ahead of us. Thank you for taking the time, and Happy Thanksgiving.

Cathie Lesjak
Happy Thanksgiving.

CONCLUSION

Operator
Ladies and gentlemen, this concludes our call for today. Thank you.