HP, Inc.

Second Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Dion Weisler - *President and Chief Executive Officer*

Cathie Lesjak - *Chief Financial Officer*

Steve Fieler - *Head of Treasury*

PRESENTATION

Operator
Good afternoon and welcome to the Second Quarter 2017 HP Inc. Earnings Conference Call. My name is Austin, and I'll be your conference moderator for today's call. 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, Steve Fieler, Head of Treasury. Please proceed.

Steve Fieler
Good afternoon. I am Steve Fieler, Head of Treasury for HP Inc., and I'd like to welcome you to the fiscal 2017 second 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. HP assumes no obligation and does not intend to update any such forward-looking statement. 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-Q for this fiscal quarter ended April 30, 2017 and HP's other SEC filings.

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, Steve. Good afternoon, everyone, and thank you for joining us today. I am very pleased with our quarterly performance. It was a breakthrough quarter where we delivered year-over-year growth in both Personal Systems and Print. As a company, we are performing across our portfolio, our regions and our key financial metrics.

Over the last six quarters, we've been building momentum, improving our business fundamentals and delivering on what we said we would do. We are taking profitable share, out executing our competitors and delivering some of the best innovation, design and execution in HP's history. Our goal is to consistently deliver on our financial commitments every quarter, while setting the company up for long term success. We are strengthening our core business and delivering on milestones in our growth and future initiatives. I am proud of the results this quarter.

Let me talk through a few of the highlights. We delivered non-GAAP diluted net earnings per share of $0.40 at the high end of our outlook range. We grew net revenue by 7% year-over-year to $12.4 billion driven by growth in Personal Systems and Print, the first time we've delivered growth in both segments during the same quarter since Q4 of 2010. We delivered free cash flow of approximately $400 million for the quarter and $1.1 billion for the first half of the fiscal year. Through the same year-to-date time period, we've returned approximately $1.1 billion to shareholders through share repurchases and dividends.

Looking at the business segment performance, Personal Systems continued to deliver and demonstrate how playing our game drives strong results. The team once again drove revenue growth year-over-year and market share expansion. We saw a small increase in operating profit dollars year-over-year at a time when significant component cost headwinds have been pervasive across the industry. This is a great example of how segmenting market opportunities, innovating and executing can yield amazing results.

For the second consecutive quarter, Personal Systems revenue grew by 10% year-over-year and importantly, once again, this is broad-based growth across all three regions, both consumer and commercial audiences and in Notebook and Workstation categories. In calendar Quarter 1, we beat the year-over-year PC market unit growth by 12 points, once again outperforming all key competitors and the market as a whole. We achieved 21.7% global market share and regained the #1 PC market position globally.

Remember that market share leadership is an outcome, not an objective. Our ability to gain profitable share is one of the true measures of success. Today, security is top of mind for consumers and the boardroom alike. Just look at the cyber security events over the past couple of weeks. With this backdrop, we continue to deliver the most secure and manageable PCs in the world with powerful new commercial notebooks and desktops including the EliteBook X360 with HP Sure View and HP Sure Click.

As part of our world class security stack, Sure View defends customers from visual hacking with a built-in electronic privacy screen. HP Sure Click protects customers and organizations from web-based security threats including malware and other viruses that we are all seeing daily in the news.

We also announced HP Sure Start, the world's only integrated browsing solution which protects our devices from malware. In addition to security, mobility is a top priority for our customers and a differentiator for HP. At Mobile World Congress, we introduced the latest HP Pro x2 with the design, security and productivity features tailored for today's mobile workforce. This discerning audience took notice, honoring the Pro x2 with several important awards including a category "Best of Show", "Top Pick" and "Top Innovation."

While the PC market has been healthier than expected during the past few quarters, the market remains highly competitive and volatile. Regardless of market conditions, I remain confident in our team's ability to deliver consistent results through a relentless focus on innovation, market segmentation and cost management. And whether it's a virtual-reality backpack, an OMEN gaming system, a DreamColor display or a premium PC, we are winning hearts and minds with the sleekest and most desirable products we have ever created. I am truly proud of what we have achieved in Personal Systems and energized by the focus, energy and talent of our people who know how to combine innovation with incredible execution.

Shifting to Printing, Enrique and his team had a breakthrough quarter with strong performance across multiple dimensions, total revenue, supplies revenue, units, market share and operating profit. Printing revenue grew 2% year-over-year with both hardware and supplies revenue growing in the same quarter for the first time since Q2 of 2011.

Units also grew year-over-year, as did our market share, while delivering operating profit expansion. It’s been a long time since we were being able to say that especially in a single quarter and we are excited to be igniting a real renaissance in printing. With solid progress on our productivity initiatives which lowers our overall cost structure, we remain better positioned to competitively price and place more units with a positive MPV. Due in part to a continued operational progress, hardware units were up 4% in Q2 our third consecutive quarter of year-over-year unit growth.

The overall print hardware market was up slightly in calendar quarter one, a bit better than expected. We continue to grow faster than the market with year-over-year profitable share gains in both our home and office businesses. I am pleased that our supplies performance strengthened this quarter with revenue up 2% year-over-year. We continued to pull levels within the 4-box model and when combined with our operational progress both having a favorable impact on the business.

In addition to improvements in our core printing business, we have also built momentum in strategic growth areas. Our Graphics business delivered another strong performance with year-over-year revenue growth in constant currency for the fifteenth consecutive quarter. We saw balanced hardware revenue growth across the portfolio as well as in graphic supplies and services. Similarly, we saw growth in contractual printing with continued increases in new total contract value for managed print services. We also grew consumer enrolment in Instant Ink and continued to expand into new geographies.

At the end of Q2, we began shipping our disruptive portfolio of A3 multifunction printers. In contrast to the established copier players, our new A3 portfolio is expected to transform the copier experience for customers and service professionals. Our differentiation includes a lower total cost of ownership, improved serviceability and the most advanced security and device uptime.

Our journey is just beginning and we are aggressively onboarding new partners and attacking new opportunities in the $55 billion A3 copier market. The acquisition of Samsung’s printing business will further accelerate our A3 portfolio. We expect the transaction to close in the second half of ’17, subject to regulatory approval and other customary closing conditions.

Turning to 3D printing, this was our second quarter of product shipments and the feedback from our customers and partners is very encouraging. Across the board, we are building momentum and advancing the entire ecosystem.

This month at Rapid, the largest 3D printing conference in the world, we announced a series of important milestones including a reseller program with more than 30 partners, more than a dozen 3D reference and experience centers across North America and Europe, a growing roster of manufacturing service bureaus and product development customers implementing HP Jet Fusion 3D printing systems for production and new applications, and we expanded our open materials platform to include new partners like Henkel, a global leader in high performance adhesive technologies. Also, just this past weekend, at the inaugural 3D printing industry awards, HP's multi-jet fusion technology was recognized as the Innovation of the Year. Disrupting the $12 trillion manufacturing sector and transforming industries is a long-term vision and one that we are making concrete, strategic progress on today. This is a multi-year journey and I am confident in this team's ability to bring disruptive innovation to market, create and empower an ecosystem and redefine the economics of production manufacturing.

To summarize, Q2 was a breakthrough quarter for us with strong year-over-year performance across our segments and regions. We are executing, meeting our commitments and capitalizing on our momentum. We are also making the right investment decisions for the long term. However, our work never ends, every single day we must continue to amaze our customers and partners with the most competitive and disruptive portfolio in our industry and provide them with meaningful value and opportunity.

Change is a constant in our business, and to us change equals opportunity. We know how to operate in up and down markets that we will continue to face, and are prepared to tackle the opportunities and challenges that lie ahead. By embracing change, we have an opportunity to accelerate, to innovate, to improve, and ultimately, to reinvent for our customers, partners, employees and shareholders.

I will now turn the call over to Cathie to provide more details and our financial outlook.

Cathie Lesjak
Thanks, Dion. Overall, I am also very pleased with our performance in the second quarter. We delivered net revenue of $12.4 billion, up 7% year-over-year. Similar to the broad-based performance we delivered last quarter, we saw strong momentum globally with each region delivering top line growth year-over-year and both EMEA and APJ growing about 10% in constant currency.

Gross margin of 19.2% was down 0.2 points year-over-year, driven primarily by strong Personal Systems growth and higher commodity cost in Personal Systems, partially offset by Print margins. Sequentially, gross margin was up 1.5 points, higher than normal seasonality, driven by a favorable Print margin combined with strong sequential growth in printing and resulting segment mix.

Non-GAAP operating expenses of $1.4 billion were up 7% year-over-year. The expense increase was driven by SG&A where the year-over-year reported growth was impacted by the gains or offsets to SG&A expense that were recognized in FY16 for the divesture of certain marketing optimization assets.

In addition, SG&A increased year-over-year as we drove more demand generation and marketing initiatives, primarily in Print. We also continued to invest more in research and development year-over-year. These R&D investments are important drivers to fuel future innovation.

Net OI&E expense was $69 million for the quarter. As a reminder, in the year-over-year compare, last year we recorded a onetime gain of about three pennies in OI&E from a favorable litigation settlement.

With the non-GAAP tax rate of 22% and a diluted share count of approximately 1.7 billion shares, we delivered non-GAAP diluted net earnings per share of $0.40. Non-GAAP diluted net earnings per share primarily excludes restructuring and other charges of $140 million and acquisition-related charges of $20 million, partially offset by non-operating retirement-related credits of $35 million, tax indemnification credits of $5 million and the related tax impact on these charges. In Q2, GAAP diluted net earnings per share from continuing operations were $0.33.

Turning to the segments, Personal Systems net revenue was $7.7 billion, up 10% year-over-year. We saw strong performance across both customer segments with consumer revenue of 16% and commercial up 7% year-over-year. While share performance is not our first priority our disciplined focus on market segmentation and innovation enabled meaningful year-over-year unit and revenue share gains in calendar Q1 across consumer and commercial.

PC average selling prices were up year-over-year and sequentially driven by favorable pricing and to a lesser extent a mix shift to premium partially offset by currency. As we highlighted last quarter, we took pricing actions globally in response to unfavorably currency and the increased cost to components.

However, the potential impact on demand and full benefit of these price increases takes time to play through, especially in commercial. As such, gross margins were down, both year-over-year and sequentially in Q2, driven by the continued component costs headwinds and currency, which weren't fully mitigated by the higher average selling prices.

The team delivered a 3.2% operating profit margin down 0.3 points year-over-year. We continued to make progress beyond the core with a focus on strategic growth category. In Q2, we saw strong growth in premium, commercial mobility and commercial services.

Turning to printing, we remain on track to deliver operational improvements in the core business while making progress on our growth initiatives. Revenue was $4.7 million in the quarter up 2% year-over-year.

Hardware units were up 4% year-over-year with growth in our consumer and commercial categories up 3% and 6% respectively. Our total unit growth includes HP Sprocket, our handheld photo printer, which continued to have strong demand and contributed to our year-over-year metric. In calendar Q1, we gained share year-over-year in both our home and office businesses with overall Print share up 0.5 points.

Overall, Print hardware revenue was up 7% year-over-year, supported by increased volume and higher average selling prices driven by both rate and mix improvements. We continue to be focused on improving our cost structure which will enable us to place more NPV positive units. Driving these positive NPV unit placements is one of the many levers to help ensure ongoing supplies revenue stabilization.

In our growth initiatives, graphics had another strong quarter growing revenues across all regions and nearly in all product categories with strong performance in Indigo. Managed Print Services new TCV was again up year-over-year, and as Dion highlighted, we shipped our first new A3 printers at the end of Q2 and look forward to scaling the business in the quarters ahead.

In Q2, total supplies revenue was up 2% nominally and in constant currency, the first quarter of year-over-year constant currency growth since Q2 2013. The year-over-year increase associated with the 4-box model drivers was better than we expected.

We have clear line of sight to supplies stabilization and expect second half supplies revenue growth to be flat to slightly up year-over-year in constant currency and adjusted for last year's changes to the supply sales model. Supplies revenue mix was 67%, flat year-over-year and channel inventory remains below our reduced ceiling.

We saw good improvement in printing operating profit at 17.4% up 0.1 point year-over-year and 1.4 points sequentially. Margin increases were driven by favorable rate due to a mix shift to the high-end of consumer and ongoing cost structure improvements, partially offset by increased marketing spend and investments in key growth initiatives.

Now turning to cash flow and capital allocation, cash flow from operations was $455 million in Q2 and approximately $1.2 billion year-to-date. Free cash flow was $380 million in the quarter and approximately $1.1 billion year-to-date.

As highlighted last quarter, we had expected Q2 free cash flow to be below Q1, primarily due to the sequential changes in revenue volume and mix from our respective segments. The cash conversion cycle was negative 30 days, flat sequentially. Quarter-to-quarter, we saw a two day increase in days sales outstanding driven by less favorable revenue linearity, which is more typical of normal seasonality.

Days inventory increased four days, primarily driven by strategic buys to help assure component supply. And finally, we saw a six day increase in days of payable, driven by purchasing linearity and more normal sequential changes.

On a full year basis, we remained confident that the revenue linearity improvements we saw in the first half, resulting some changes to our supply sales model, are structural improvements. Therefore, we continue to expect that our free cash flow could be at the higher end of our $2.3 billion to $2.6 billion outlook for the year.

During the quarter, we had a total capital return of $447 million through share repurchases and cash dividend. Year-to-date, we have returned 95% of free cash flow, as compared to our full year target of 50% to 75%, so we remain well on track to deliver on this commitment.

Looking ahead, keep the following in mind related to our financial outlook. For the full year we are on track to deliver our productivity initiatives as announced at SAM. We have accelerated the timing of certain restructuring charges from fiscal 2018, where the incremental 2017 GAAP expenses will be offset by lower 2018 GAAP expenses. Many of these restructuring charges are lumpy in nature and the timing is more difficult to predict, which leads to keeping a wider full year GAAP outlook range relative to our narrowed non-GAAP range.

In Personal Systems, we have increased pricing globally in response to the increased cost to components and unfavorable currency impacts, which could have a more significant impact on demand and operating margins than we've assumed.

For Printing, we expect supplies revenue to be flat, to slightly up in the second half in constant currency and adjusted for last year's supplies sales model change. We also expect to continue pricing units with a positive NPV.

With all that in mind, Q317 non-GAAP diluted net earnings per share is in the range of $0.40 to $0.43. Q317 GAAP diluted net earnings per share from continuing operations is in the range of $0.36 to $0.40. We are raising our full year fiscal 2017 non-GAAP diluted net earnings per share to be in the range of $1.59 to $1.66 and our full year fiscal '17 GAAP diluted net earnings per share from continuing operation is in the range of $1.42 to $1.52.

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

QUESTION AND ANSWERS

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 pick up your handset before pressing the keys, to withdraw your question, please press "*" then "2." We request that you limit yourself to one question and one follow-up.

And our first question comes from Shannon Cross with Cross Research. Please go ahead.

Shannon Cross
Thank you very much; it's nice to see both PCs and printing growing again. My first question is on the PC market. I would like to follow-up on the comments regarding price increases. What have you seen initially from the market and perhaps on a geographic basis? And then also what are you seeing from your competitors? And then I have a follow up. Thanks.

Cathie Lesjak
So Shannon, let me start with what we're seeing, what we did. We increased prices in both Q1 and Q2. In Q2, what we saw was the consumer price increase basically take and flow through in the quarter, so it has a much quicker impact than on the commercial side. Commercial, that takes some time to actually work through the system, so we didn't see that as much in Q2. We do expect that we will see the price increase flow through in Q3, but the flip side of that is of course we didn't see the demand impact either of that price increase. So at this point in time, there is a little bit of uncertainty as to what we will see moving into Q3 and Q4 from those price increases in commercial.

Dion Weisler
And Shannon, the only other thing I would add is that I think we saw this relatively early, I believe I mentioned it a couple of quarters ago, and as a result of that, the first thing we did was went and shored up supply for the full year because we wanted to make sure that we are able to fulfill the demand that we are seeing flow through the pipeline. With that said, it becomes a constant daily set of work that the team does to continue to work costs down in other areas of the business in the complete bill of materials, in the workflow that we drive every single day. So we saw this coming, I think we reacted to it and we are leveraging our balance sheet to ensure that we have surety of supply.

Shannon Cross
Thanks, and then second question is just on the Printing operating margin. Supplies seem to be improving a little ahead of schedule, which obviously is going to benefit margins, but I am curious how you think about the balance flow through of investment of those dollars into 3D printing, A3, other growth initiatives, versus letting them fall to the bottom line. So how are you

balancing that and how should we think about operating margin as you go through the year? Thanks.

Cathie Lesjak
So I think the way to think about it, and we talked about this before, is that we expected the Print operating margin, which has historically been in the mid-teens, will continue to be in the mid-teens, that's 15% to 18% and that the variability within that range is largely going to be driven by the opportunity to place more units. For '17 specifically, we are very focused on our productivity initiatives and realizing those as we progress through the year. We are also taking some of the savings, a lot of the savings frankly, that we are getting from lower discount dollars around supplies directly related to the supply sales model change that we made last year, and we are basically reinvesting those back into marketing.

We told you we were going to do that and that is in fact what is happening. We are doing that in order to drive print relevancy, drive more print and also to drive preference for HP-branded supplies. And then finally, we are investing. We are investing in A3, we are investing in graphics and we are investing in 3D.

Operator
And our next question comes from Steve Milunovich with UBS. Please go ahead.

Steve Milunovich
Thank you. Cathie, on the supply side, just to clarify again, you talked about flat up in the second half including the adjustment for last year, so I take that to mean that the reported number will be something up like 5%. I just want to clarify that. And do you have any view on what the longer-term supplies growth rate is likely to be or will there be any growth in Supplies?

Cathie Lesjak
To the first part of your question, the second half, yes, the reported numbers will be higher from a growth perspective in the second half because we had such a significant adjustment to channel inventories in last year's second half. And in terms of the longer-term view of supplies, I think one of the things that we have been saying pretty consistently is that getting to supply stabilization in constant currency, and again just for these sales model changes, is the first milestone. It is not that in Q1 we then breathe a sigh of relief and we don't have to do it again, so we recognize that we are at a minimum maintaining the stabilization in constant currency, in supplies over a longer time period. Exactly what that's going to look like, we will talk more at our security analyst meeting later on in the fall.

Steve Milunovich
Okay. And Dion, I wanted to ask you about the A3 market. I think you have said that you are not really a player unless you had about a 10% market share. Do you have a sense of when you are going to get there and are you finding that you are able to develop the channels that you need?

Dion Weisler
I will reaffirm that I think to be relevant in any marketplace that you want to have at least 10% market share and then you become relevant, particularly in a channel-driven business. You become relevant to those channel partners and relevant to customers and so, we want to get there as quickly as possible. Having said that, we have only just started to ship our range of A3 products and we are excited by the reaction to the products that we have already delivered. The pipeline is very healthy. We are onboarding both existing partners and a very new universe

of partners that we have never transacted within the past. The additional benefit of that is that as we take on these new channel partners, we are finding additional A4 opportunities within the new partner base and within customers that we have never dealt with in the past because they have a blended mix of A3 and A4. So, this is ongoing work. It is early days. I am excited by what I am seeing across the globe in terms of the commitment to driving our A3 business and we will continue to remain focused on it.

Operator
Our next question is from Katy Huberty with Morgan Stanley. Please go ahead.

Katy Huberty
Yes, thank you. Congrats for the quarter. Cathie, you beat our free cash flow estimates the past two quarters, why not raise the range for the full year? Is there anything coming in the back half? Certainly, the component environment I imagine, inventory remains high, I know there is an SAP upgrade that you're either in the midst of or is upcoming. Are there any dynamics in the back half that keep you conservative on free cash flow? Then I have a follow-up.

Cathie Lesjak
I don't think there is anything that is out of the ordinary that is coming up in the back half that is keeping us "conservative," to use your word. I think it is more that we typically don't update our free cash flow guidance in the year. We put a range out there and we stick to it and then we give a little bit of color. And so, the color that I have given is that frankly I do think we could be at the higher end and we will see. Now, there is also a lot of volatility in free cash flow as a result of what the business does. So if you have got Print, in this quarter, we have Print increasing sequentially much more than is their normal pattern. Similarly, we had Personal Systems out of their norm as well. They decreased more than is the norm. And so, that can have a pretty big swing, a pretty big impact on free cash flow. So there is a little bit of that that we are playing through as well. That could mean that we could be higher. It could mean that we are bit lower in the range.

Katy Huberty
Okay, understood. And as a follow-up, what percentage of the PC and printer business now is as-a-service and are there any implication as it relates to CAPEX or timing of payments from customers that could change the free cash flow model longer term? Thank you.

Cathie Lesjak
The contractual piece of our business is not that significant today to be putting any kind of real pressure on free cash flow or on CAPEX in general, so I don't think that's a concern of ours. It is moving in the direction, it is growing and we like the fact that it is growing, but we don't see a significant impact from it in fiscal '17.

Operator
Our next question comes from Toni Sacconaghi with Bernstein. Please go ahead.

Toni Sacconaghi
Yes, thank you. I have one for you Cathie and one for Dion. You had talked about how we should think about adjusting supplies' growth rate for drawdowns in channel inventory and last year in fiscal Q2, you said that supplies were negatively impacted by 7% from a drawdown in channel inventory, which would point to about $250 million drawdown in inventory last year in Q2. So if we add that back to last year, it actually looks like on an inventory adjusted basis

Supplies were down 5% or 6% this quarter in Q2. Is that the right way to think about it or were there some supplies inventory draw-downs this quarter?

Cathie Lesjak
So there were also year-on-year inventory drawdowns this quarter. If you think about the fact that we did that pretty significant step down in channel inventory in Q3 and Q4 of last year and then we have continued to keep channel inventory at those levels or even a little bit lower. I think in Q1, I mentioned that sequentially we were down you know in terms of WOS, we are down again both year over year and sequentially. And so, there is a little bit of an add-back as a result of those drawdowns in channel inventory.

Toni Sacconaghi
Okay. We can take it offline. But I think unless it came down this quarter, it doesn't really matter because I am comparing 13 weeks of sell-out this quarter versus effectively 12 weeks of sell-out last quarter and that's where I get the differential. If it came down in the interim, I don't think it really matters, but I am happy to debate that offline.

Dion, and my second question, you have done a great job in PCs in being a sustainable share gain, I think it's been almost 20 quarters, your strong growth right now is benefitting from really good share gains, but the market is still pretty weak and you know quite frankly, your year-over-year comparison was pretty easy, it was minus 10%. So as we look to the back half of the year, particularly the fourth quarter when the Personal Systems comparison goes to plus 4% and you've expressed some hesitation about price increases and how that might impact demand, is it realistic to think that HP can continue to grow PC revenues in the third and fourth quarters and how do we think about the trade-off between a 4% operating margin or revenue growth in your eyes and how do you think about that?

Dion Weisler
Thanks for the question Toni. Let me just say that, as you know, we don't guide revenue, but what I will tell you is that we don't broadly disagree with how the industry analysts view the PC market. We look back 18 months ago and we are in double-digit declines and since that time the market's been steadily improving to the point where it grew this quarter and depending on which analyst you speak to, they are in the range of between minus two and plus two, and we don't broadly disagree with that range through the remainder of the year. What I will say is that, I am very confident in our team's ability to out-execute the market and out-execute our competitors, and we do that with a fairly complex formula of segmenting the market, segmenting it again, finding the pockets of growth within the market using fairly sophisticated heat maps and understanding where we believe the heat is going to be in the market.

And we know that we can't cut our way the glory that we need to innovate our way to success, so we spend a lot of time and energy on innovation that matters to our customers. We spend a lot of, as a good example, a lot of energy on security, multiple levels of security: below the operating system, at the operating system, above the operating system, and we are seeing that really resonate with our customers right now. Again, you have to look at the last couple of weeks where there has been a lot of global security concerns and we've got a tremendous answer for that, and we are being rewarded for that innovation that we build into the product. So you can expect to see us continue to innovate, you can expect to see us continue to take costs out of the business. You can expect to see us continue to segment, drive to where the heat is in the market. It's a formula that's been working well for us as you pointed out at the start of your remarks. And I think when we do that in a market that is minus two to plus two depending on where you go, I think we can outperform the market.

Operator
Our next question comes from Jim Suva with Citigroup. Please go ahead.

Jim Suva
Thanks very much and great results. Cathie, you mentioned that you are raising your full year non-GAAP EPS which is good to see, but the GAAP has gone lower and you mentioned something about restructuring. Is that accelerating, pulling them into this year, and then you are going to see the benefits sooner than expected or how should we think about why there is the disconnect there and about the timing of the benefits of such?

Cathie Lesjak
So yes, we are pulling in restructuring from fiscal 2018, or at least some charges, I think the way to think about it is that we are pulling in charges from 2018 into 2017 and that is impacting the GAAP number, but we've also got a wider gap range, and the reason we've got that is that some of these charges can be… you determine what quarter you take them in by some very specific accounting rules and sometimes that tips the scale as to what quarter it fits in. And I will give you a really good example. This quarter, we announced that we are closing Irish manufacturing and there was this very detailed list of things that you had to check the box on in order to recognize the charge this quarter. It just as easily could have been basically recognized next quarter. If that happens in Q4, then we have something that falls out, something that falls in. So we've got a much wider range from a GAAP perspective, but in the big scheme of things we are pulling in some of the restructuring charges into 2017.

In terms of the benefits really what we've talked about is that, this restructuring program is a three-year program, roughly $300 (million) to $500 million worth of charges over that time period, we still believe that we will be in that range, and that the savings on a full year basis will be $200 (million) to $300 million a year beginning in FY '20 and that we continue to believe that's the case.

Operator
Our next question comes from Kulbinder Garcha with Credit Suisse. Please go ahead.

Kulbinder Garcha
Thank you. I have just a couple of clarifications on margins going forward. On the Printing margin, it sounds like the supplies should be higher in the revenue mix, so should we expect Printing margins over the back half of the year to expand from this level or are there other puts and takes we should be aware of? And on the PC margins, is the current run rate reflective of the tightness in the cost and in the component cost environment. And would you say this is a new base or are there cost initiatives that could take that up and ASPs increasing should help going forward or how should we think about the direction of those margins in the back half of the year? Many thanks.

Cathie Lesjak
Okay. So from a Print perspective, we still expect that the Print margins will stay in the mid-teens, 15% to 18%. The offset to what you are talking about in terms of maybe a bit of a tailwind from a supplies perspective is the fact that we want to place as many NPV positive units, so that we keep the flywheel effect of placing units, getting supplies, placing units and getting supplies going. So that's the optimization of the area under the cure that we talked about the Securities Analyst Meeting.

On the personal system, some of things you should think about. One is the commercial price increases really haven't really shown up yet in Q2, expect them to show up more in Q3, but we also are expecting there could be some demand response to that. And then on top of that, the commodity costs increased pretty significantly year-over-year and quarter-on-quarter in Q2. We expect that they are going to continue to increase, albeit at a slower rate, in Q3. So there will be an incremental headwind as a result of those commodity costs going up in Q3. And then we are just at a total company level we've talked a lot about billion dollars in productivity initiatives that we've got going and they ramp, they are ramping and are more backend loaded which we have been talking about most of the year.

Dion Weisler
And then, just additional clarification to Toni's question and your question, we haven't really changed our view on the PC business, we think it's in the range between 3% and 4%.

Operator
Our next question comes from Amit Daryanani with RBC Capital Markets. Please go ahead.

Amit Daryanani
Thanks a lot guys. A couple of questions from me as well. Cathie, could you just talk about the cash conversion cycle, how you expect that to track in the back half. And I guess, looking at accounts payable get into 100 days; is that something that's sustainable in your opinion. And another side I think inventory days went as well. So do you think these just normalize each other and offset in the back half or is there room for conversion to actually improve especially DP stay north of 100?

Cathie Lesjak
Sure, so I am very pleased with the progress that we are making from a cash flow perspective. We over the last probably year-ish have been really driving cash flow in the company at just about every level in the company. So employees really understand the importance of free cash flow, they understand what role they play in helping us to drive free cash flow. And I think if those as being really sustainable.

Secondly, we did make a change to our supply sales model last year and that is driving better linearity, real structural better linearity, linearity in the quarter that mirrors the demand that we are seeing, and that has also then provided benefit, because we are basically shipping revenues earlier in the quarter beyond the fact that and we also do it at a lower discount level, and so, that's real structural improvement.

In the outlook that we've provided on for a free cash flow of $2.3 (billion) to $2.6 billion, and like I said, I think frankly we could be at the higher end as a result of the supplies change that we made, it has…what's assumed in that is that we are…our cash conversion cycle is flattish, maybe down a day or two within that range. And so, I think that's the way to think about, is it sustainable, it's probably going to be in the minus 28 to minus 30 kind of range.

Amit Daryanani
Got it. That's very helpful. And when you talk about this, the Printing segment margin and you said 15% to 18% of the target, is that a reasonable target once the Samsung assets are rolled in and integrated as well or does that dilute that a little bit at least in the initial part of it, once you get the deal?

Cathie Lesjak

Samsung is in investment mode right now as we talked about when we announced the Samsung deal, and then we also said on the call is that we would expect that the deal would be accretive in the first full year. So it starts out in investment mode and then ramps from there, and that is not included in obviously any of our fiscal '17 outlooks at this point in time.

Operator
Our next question comes from Wamsi Mohan with Bank of America Merrill Lynch. Please go ahead.

Wamsi Mohan
Yes, thank you. Dion, maybe you could talk about what you are seeing in HP original supplies attach, how that has evolved over the past year or so, how much more room do you see over the next few years in driving increased attach, given that's of, you know, relatively high significance to your strategy over the past several years.

Dion Weisler
Yes, it's a great question. Thank you, Wamsi. I think about the entire 4-box model when I think about our supplies business and its stabilization. And so, I will comment a little bit on each of the levers. I mean, the 4-box model continues to predict supplies. Revenue will stabilize in constant currency and adjusted for the change in the supply sales model by the end of '17. It's also performed in line with all better than our expectations we had at the beginning of each of the four prior quarters, and recall that we changed the supply sales model due to the increased impact of the Omni-channel environment and believe that this would be a more efficient model, and it is certainly proving to be a more efficient model. Our execution of the demand driven change has seen improved sell-out linearity. We are holding less weeks of stock in the channel inventory, both year-over-year and quarter-over-quarter as Cathie mentioned. And we are achieving the cost savings that we previously had put towards discount dollars and that's supporting an increase in the marketing to drive the Print relevance, and that's really at the center of your question, that the increase in the marketing dollars in the stable environment out there is enabling us to sell the value of original supplies, and as a result of that, that has an impact on that particular box. But we are making improvements in all four areas, the install base continues to improve in terms of size and shape, usage, we have a lot of focus on usage obviously in terms of marketing spend, and also in the change of the different models that we have Managed Print Services and Instant Ink, of course, impact the box that you are talking about, the original supplies, and we sell a Managed Print Service contract and Instant Ink it comes with increased HP original supplies. And so, we are happy about that and obviously maintaining a uniform price environment is helpful. So I think on many dimensions the results we are starting to see flow through the Printing business are as a result of the work that the team is being doing across all 4-boxes and the one that you mentioned is obviously a big part of that.

Cathie Lesjak
And maybe I will throw another data point. So, Graphics continues to grow both nominally and in constant currency. So the Graphics growth in supplies specifically was low to mid-single-digits on the back of about a double-digit improvement in pages printed and impressions. And so that continues to be part of the strategy as well as we talked about core growth in future in the growth category is graphics and we are continuing to make good progress there.

Operator
Our next question is from Mark Moskowitz with Barclays. Please go ahead.

Mark Moskowitz
Thank you. Good afternoon. The first question is around the second half of the year, just trying to understand why the guidance seems a little conservative given the goodness this quarter and the trend line in Printing. Is there something else that you are been maybe careful with in terms of peaking market share momentum, maybe some channel dynamics that have you a little concerned, where you want to make sure the channel sell-through is better or was it “other”, would be the question?

Cathie Lesjak
So, Mark I think we have been prudent in our outlook. I don’t think that we see anything specifically looming that is making us be more conservative than we have typically been. There are a lot of different things going on in the market all of which are not easy to call, the uncertainty in the PC market around commodity pricing, commodity availably, the demand impact of raising prices, those are some of the things that weigh on the market. And therefore, we are trying to take that into consideration. We are also trying to take into consideration just the uncertainty that exists in the currency markets. On a year-over-year basis, currency has not been, you know, too big of an impact on the top line, little bit more on the bottom line, but understanding what the impact is going to be of US policies and even the full impact of Brexit, there is enough uncertainties out there, that we think that it is prudent that our outlook is prudent.

Mark Moskowitz
Okay, fair enough. The follow-up question is around Katy's question earlier in terms of as-a-service. Can you give us a sense in terms of how investors should think about that business vector being potentially material to both Printing and/or PCs? Is that a 2018 or is that more of a 2020 phenomenon?

Cathie Lesjak
I think it’s a longer-term phenomenon. We are making progress for sure, we are seeing the move from transactional to contractual, but it is not at a rate that says it’s going to be really material. And we will talk more about this at the security analyst meeting. We talk a little bit longer term and it’s definitely a trend in the market, we think it’s good for us over the long-term. But it is not going to have a material impact in the short-term.

Dion Weisler
The last data points I've seen and it's going back a little way, not too far back, was, there was a six point swing from transactional motions to contractual motions, faster in mature markets than emerging markets. I would say that again like most of the areas where we are focused on, we are out-executing the industry average on that. And as a result of that our pipeline is growing steadily for Device-as-a-Service, Mobility-as-a-Service, obviously Managed Print Services, we're sort of 10 years into that journey already, it’s quite mature for us. So I expect it is an ongoing customer trend. More and more customers want to have a contractual relationship and when we provide them the capability to do across their Personal Systems and Print platforms, it’s always a different kind of conversation. So I expect it is a trend that will continue better as Cathie mentions. It doesn’t become absolutely material for sometime in the future.

Cathie Lesjak
The Managed Print Services revenue, is growing low to mid-single digits, so the trend is there but it’s just not an exponential increase.

Operator
And our final question for today will come from Maynard Um with Wells Fargo. Please go ahead.

Maynard Um
Hi, thanks. So, part of the bear thesis is that the print market is in secular decline yet you've still been able place high NPV printers now pretty consistently. Is there a point where you think you won't be able to place any more of these printers and we start to see those profits slow down, or has there been a change in the secular story in the broader print market? Then I have a follow-up.

Dion Weisler
I would say that, generally speaking the answer always lies much more deeply down in the segmentation that you can't tackle the print market with the single brush. Obviously, there were areas with clear secular decline in the consumer market and we said we don't think it's likely, we said it back at SAM, we don't think it's likely that we can turn that market back into growth. But, our job is to reduce the glide slope of descent and I think with the new range of consumer printing devices we've bought to market introducing brand new categories like Sprocket, which is doing incredibly well, and attracting customers that have never printed before, many millennials that have had their photos trapped in their phones are now able to free them by having a Sprocket in their pocket. And that's goodness for the category and obviously we remain focused on the high quality NPV units.

We are getting a lot more big data; we are leveraging that big data to understand exactly where we are going to make those investments. And I think that segmentation of pockets of growth and opportunity of growth will continue in the market. And let's not forget we are very new entrants into the A3 copier market, that's a $55 billion market and we have less than 4% market share. So that is why we have a strategy that has a core element to it, the vast majority of our revenue and operating profit today, but a very clear growth element to it, in terms of Graphics in A3 and commercial mobility and we see that playing out over the next two to three years. And then, adding to the future with blended reality and immersive computing on the one hand and 3D printing on the other provides us opportunity for a long-term growth 3 to 10 years-plus out.

Maynard Um
Thanks. And if we look across your businesses, you should have an improving mix shift to higher margin business, some of the ones you mentioned in the past like the accessories, the displays, gaming, commercial graphics, obviously we know the size of some of these, but are all of these, the other businesses at a level of scale that can now help you to move the needle for you on the margins and how much runway do you think you have for growth in these businesses? Thanks.

Dion Weisler
Well, I think if we take by way of example, the Personal Systems market is a $333 billion market, but about half of that market is the non-core stuff that most of us think and talk about, notebooks and desktops, detachables and convertibles. So, the other half of the market is I think clients and services and accessories and displays, and in many of those markets were underpenetrated. And many of those markets they come at higher margins. So as we index our way up into that part of the market, it's a very clear strategy of Ron and his team as we execute against our Personal Systems and that helps offset the higher pressured areas of some parts of the core business and the same is true for Printing as we just highlighted.

Cathie Lesjak
And then the other thing that's going on in Personal Systems in what we think of as the core businesses, is there a positive mix shift going on and that leads to units increasing or decreasing and at the different rate than what revenue is. And we have been ahead of that positive mix shift, so if you looked IDCs revenue growth for PCs in calendar Q1, it was up more than units, so units were up 0.8 points. And they expect for the rest of the year that units will be down a bit, but that revenue will be flat. And as I said, we are head of that trend, and so we are benefitting and basically gaining REV share.

CONCLUSION

Dion Weisler
So, thank you for the questions and thank you all taking the time to join us today. I continue to gain confidence quarter-after-quarter as the team embraces change and turns that change into opportunity. I characterize the quarter as a breakthrough quarter for us, delivering growth in both segments, Printing and Personal Systems, again that's the first time since FY'10. We are taking profitable share, we are out-executing our competitors and we are delivering some of the best innovation I think this company has ever seen. But we remain humbled by that. Every day we must continue to amaze customers with the most competitive, disruptive portfolio on the planet. And we are playing offense and I think that's the right place for us to be. And I think our most innovative days and best days lay ahead of us. Thanks very much for joining us.

Operator
The conference has now concluded. We thank you for attending today's presentation. You may now disconnect your lines.