

## Excellent Risk-Reward and High-Income Make the HPE 7.625s an Attractive Instrument to Position for HPE's Continued Recovery

HPE has \$1.5billion in face of mandatory preferred outstanding. In this note we take a detailed look at the mandatory, its terms and features and why it is an attractive security for convert & growth and income equity investors.

### Structure and Terms

Mandatory convertible preferreds are preferred securities that have a fixed life, typically three years. At maturity (9/1/27) the security will mandatorily and automatically convert into shares of the underlying equity, HPE in this case.

Each preferred stock has a face value (\$50 in this case) on which the dividend is paid quarterly (Starting Dec 1 2024 and ending on and including Sep 1, 27). Note that preferred dividends take precedence over common dividends. HPE pays a 13c dividend (3.15% yield) or ~\$683 million per year on ~1,314 million shares outstanding. The preferred dividends are protected by this buffer of \$683 million in common dividends which have to be cut fully (if at all) before any preferred dividend can be halted.

### Sharp YTD Stock Decline Followed by a Bit of Recent Recovery

HPE's stock declined ~51% from its 1/22/25 high of \$24.66 to \$11.97 on 4/4/25 due to a combination of margin compression, disappointing profit outlook, tariff-related cost pressures, execution missteps, Juniper acquisition uncertainty (DOJ), and broader market weakness.

Since the lows the stock has recovered partially to \$16.49 given positive sentiment after Elliott Management's announcement of its activist stake, improved sentiment, ongoing business strength in key segments, and attractive valuation levels.

### Attractive Risk Reward

Average 12M consensus target currently stands at ~\$18.50 reflecting ~12.2% upside potential. The mandatory's income component dampens the downside over the life of the security while still allowing investors to participate in a large part of the upside. The analysis and risk-reward table below has the details. The mandatory carries an attractive risk-reward relative to common. Through maturity for a +/-20% stock price move in common the mandatory is projected to return +16.8%/-1.2% in total. For +/-30% stock price move the mandatory is projected to return +25%/-11.2% in total.

## Low Valuation Multiple, Scale & Cost Synergies and Expected Growth make HPE Stock an Attractive Recovery Story

If the DOJ case goes in favor of HPE/Juniper, the acquisition should provide HPE opportunities for increased revenue and cost synergies. The HPE/JNPR combination is expected to move HPE toward higher-growth solutions and strengthen its high-margin networking business.

The growth of AI and hybrid cloud-driven business should accelerate demand for secure, unified technology solutions. HPE intends to align its portfolio to capitalize on these major trends and is well positioned to provide a wide suite of critical enterprise technology solutions.

HPE is geographically diversified (2024 Net Revenue: U.S. \$10.9b, Americas ex U.S. \$2.3b, EMEA \$10.2b, Asia Pac & Japan \$6.7b).

HPE is also well diversified along product lines (2024 Net Rev: Servers \$16.2b, Hybrid Cloud \$5.4b, Intelligent Edge \$4.5b, Financial Services \$3.5b).

The stock currently trades at an attractive low trailing multiple of 7.85x and a forward multiple of 9.12x.

LTM revenues of ~\$31.2b generated \$2.8b of Adj. Net Income (7.7% margin). Current total debt is at \$17.8b vs. Adj EBITDA of \$5.0b and FCF of \$1.65b making the dividends well protected in our opinion. HPE’s debt is rated investment grade (Baa2/BBB).

The HPE mandatory stands to benefit from an attractively valued underlying stock in our opinion.



## Key Terms of the Mandatory Convertible Preferred

- Dividend protection: If the common dividend increases above the 13c/q threshold (HPE 5yr common dividend growth is 2.26%) the conversion ratio of the HPE 7.625% preferred will be adjusted upward.
- The 7.625% preferred has a credit rating of BB+ by Egan-Jones
- Call protection: Mandatory convertible securities typically have no call feature and this security is not callable through life.
- Preferred income that investors receive is typically 'Qualified Dividend' income and is therefore taxed at the lower capital gains rate rather than as ordinary income that interest income is subject to. So, on an after-tax basis investors benefit by keeping more of the dividends on a post-tax basis. This is a key positive of preferred income vs interest income (*this is not tax advice, kindly consult with your tax professional*).
- The stock price at issue was \$16.0999 with an initial premium of 22.50% and high strike price of \$19.7223. At maturity based on a 20 day VWAP
  - if HPE stock < \$16.0999, mandatory holders will receive 3.1056 shares of HPE
  - if HPE stock > \$19.7223, mandatory holders will receive 2.5352 shares of HPE
  - if HPE Stock is in between the above range holders will get linearly prorated shares between 3.1056 and 2.5352 such that their value is equal to \$50

## High Income Mandatory Convertible – A Concise Primer

- Mandatory convertible preferreds are preferred securities that have a fixed life, typically three years. At maturity the security will mandatorily and automatically convert into shares of the underlying equity.
- Each preferred stock has a certain face value on which the higher preferred dividend is paid quarterly. Note that preferred dividends take precedence over common dividends i.e. the preferred dividends cannot be cut or stopped unless all common dividends are halted. This affords mandatory convertible investors some protection buffer against dividend cuts/halt. Typically, the dividends are cumulative.
- In exchange for the higher dividends, investors give up some of the upside relative to equity but the instrument is still fairly equity sensitive. At maturity, investors receive
  - a high fixed conversion ratio if the common stock is at or below the low strike price
  - a lower fixed conversion ratio if the common stock is at or above the high strike price
  - linearly variable number of shares between the high and low conversion ratio when the common stock is between the low strike and high strike prices such that the value equals the face value
- Dividend protection: If the issuer raises the common dividend above the initial threshold the conversion ratio of the mandatory preferred will be adjusted upward as per a proportion-based formula.
- Call protection: Mandatory convertible securities typically have no call feature and are not callable for life.
- The income that investors receive is 'Qualified Dividend' income and is therefore taxed at the lower capital gains rate rather than as ordinary income that interest income is subject to. So, on an after-tax basis investors benefit by keeping more of the dividends relative to corporate bonds with equivalent coupons.
- By investing in mandatory convertibles investors benefit from gaining exposure to stocks and at the same time receive higher income to satisfy current income investment goals. Otherwise, to gain income investors are restricted to a certain set of lower growth, high dividend paying equities only. Mandatories open up an avenue to invest in higher growth low common dividend equities but with a chunky income component.

Mandatory vs. Stock Total Return: HPE 7.625% Projected to Deliver Competitive  
Upside Returns with High Current Income and Dampened Downside

Stock Price Change at Maturity (%)	Stock Price	10 Stock Dividends over Life	Mand. Terminal Price	10 Mand. Dividends over Life	Stock Total Return 09/01/27	Mand Total Return 09/01/27
-80%	\$ 3.30	\$ 1.30	\$ 10.24	\$ 9.53	-72.1%	-61.3%
-70%	\$ 4.95	\$ 1.30	\$ 15.36	\$ 9.53	-62.1%	-51.3%
-60%	\$ 6.60	\$ 1.30	\$ 20.48	\$ 9.53	-52.1%	-41.3%
-50%	\$ 8.25	\$ 1.30	\$ 25.61	\$ 9.53	-42.1%	-31.3%
-40%	\$ 9.89	\$ 1.30	\$ 30.73	\$ 9.53	-32.1%	-21.2%
-30%	\$ 11.54	\$ 1.30	\$ 35.85	\$ 9.53	-22.1%	-11.2%
-20%	\$ 13.19	\$ 1.30	\$ 40.97	\$ 9.53	-12.1%	-1.2%
-10%	\$ 14.84	\$ 1.30	\$ 46.09	\$ 9.53	-2.1%	8.8%
0%	\$ 16.49	\$ 1.30	\$ 50.00	\$ 9.53	7.9%	16.5%
10%	\$ 18.14	\$ 1.30	\$ 50.00	\$ 9.53	17.9%	16.5%
20%	\$ 19.79	\$ 1.30	\$ 50.17	\$ 9.53	27.9%	16.8%
30%	\$ 21.44	\$ 1.30	\$ 54.35	\$ 9.53	37.9%	25.0%
40%	\$ 23.09	\$ 1.30	\$ 58.53	\$ 9.53	47.9%	33.1%
50%	\$ 24.74	\$ 1.30	\$ 62.71	\$ 9.53	57.9%	41.3%
60%	\$ 26.38	\$ 1.30	\$ 66.89	\$ 9.53	67.9%	49.5%
70%	\$ 28.03	\$ 1.30	\$ 71.07	\$ 9.53	77.9%	57.7%
80%	\$ 29.68	\$ 1.30	\$ 75.25	\$ 9.53	87.9%	65.8%
90%	\$ 31.33	\$ 1.30	\$ 79.43	\$ 9.53	97.9%	74.0%
100%	\$ 32.98	\$ 1.30	\$ 83.61	\$ 9.53	107.9%	82.2%
110%	\$ 34.63	\$ 1.30	\$ 87.79	\$ 9.53	117.9%	90.4%
120%	\$ 36.28	\$ 1.30	\$ 91.97	\$ 9.53	127.9%	98.6%
130%	\$ 37.93	\$ 1.30	\$ 96.15	\$ 9.53	137.9%	106.7%
140%	\$ 39.58	\$ 1.30	\$ 100.33	\$ 9.53	147.9%	114.9%
150%	\$ 41.23	\$ 1.30	\$ 104.51	\$ 9.53	157.9%	123.1%

## Hewlett Packard Ent (HPE) 7.625% Mandatory Pfd

Issuer	Hewlett Packard Ent
Common Ticker	HPE
Mandatory Ticker	HPE C
Sub Industry	Tech Hd Ware/Stor.
Mandatory Shares Outstanding	30,000,000
Par Amount	\$50
Size (\$mn)	\$1,500
Years to Maturity	2.35
Maturity	9/1/2027
# of Mand. Cpns Remaining	10
Dividend Protection Threshold (\$/q)	\$0.13
Current Common Dividend (\$/q)	\$0.13
Mandatory Cpn (%)	7.625%
Mandatory Current Yield (%)	7.46%
Stock Dividend Yield (%)	3.15%
Mandatory - Common Inc. Pickup (%)	4.30%
Common Shares Outstanding (mn)	1,314
Total Annual Common Div (\$mn)	\$683

Key Ratios	
Max Conversion Ratio	3.1056
Low Strike (\$)	\$16.1
Min Conversion Ratio	2.5352
High Strike (\$)	\$19.72
Initial Conversion Premium	22.5%
Conv. Ratio Based on Current Stx Px	3.044148066

Mandatory Pricing & Profile	
Convert Price	\$51.12
Stk Px Ref (\$)	\$16.49
Parity (\$) based on Est. Spot Ratio	\$50.2
Premium (\$) based on Est. Spot Ratio	\$.9200
Premium (%) based on Est. Spot Ratio	1.83%
Total Remaining Mand. Cpns (\$)	\$9.5300
Delta (%)	80.7%

Stock Price Action	
Current Stock Price	\$16.49
52 Week High	\$24.66
52 Week High Date	1/22/2025
52 Week Low	\$11.97
52 Week Low Date	4/4/2025
Current vs. 52W High	-33.1%
Current vs. 52W Low	37.8%
12M Consensus Target Price	\$18.5
% to 12M Consensus Target Price	12.2%

## Key Financials Snapshot

In Millions of USD 12 Months Ending	FY 2022 10/31/2022	FY 2023 10/31/2023	FY 2024 10/31/2024	Current/LTM 01/31/2025	FY 2025 Est 10/31/2025	FY 2026 Est 10/31/2026
<b>Market Capitalization</b>	<b>18,279.9</b>	<b>19,732.5</b>	<b>25,283.6</b>	<b>21,660.9</b>		
- Cash & Equivalents	4,163.0	4,270.0	14,846.0	13,431.0		
+ Preferred & Other	45.0	56.0	64.0	58.0		
+ Total Debt	13,484.0	13,515.0	19,816.0	17,877.0		
<b>Enterprise Value</b>	<b>27,645.9</b>	<b>29,033.5</b>	<b>30,317.6</b>	<b>26,164.9</b>		
<b>Revenue, Adj</b>	<b>28,496.0</b>	<b>29,135.0</b>	<b>30,127.0</b>	<b>31,226.0</b>	<b>32,452.1</b>	<b>34,247.4</b>
<i>Growth %, YoY</i>	2.6	2.2	3.4	11.2	7.7	5.5
<b>Gross Profit, Adj</b>	<b>9,506.0</b>	<b>10,239.0</b>	<b>9,878.0</b>	<b>9,716.0</b>	<b>9,399.4</b>	<b>10,099.9</b>
<i>Margin %</i>	33.4	35.1	32.8	31.1	29.0	29.5
<b>EBITDA, Adj</b>	<b>5,080.8</b>	<b>5,262.0</b>	<b>5,288.0</b>	<b>4,983.0</b>	<b>5,299.5</b>	<b>5,768.5</b>
<i>Margin %</i>	17.8	18.1	17.6	16.0	16.3	16.8
<b>Net Income, Adj</b>	<b>2,203.0</b>	<b>2,298.1</b>	<b>2,815.0</b>	<b>2,822.0</b>	<b>2,506.8</b>	<b>2,873.5</b>
<i>Margin %</i>	7.7	7.9	9.3	9.0	7.7	8.4
<b>EPS, Adj</b>	<b>1.67</b>	<b>1.75</b>	<b>2.13</b>	<b>2.10</b>	<b>1.80</b>	<b>2.05</b>
<i>Growth %, YoY</i>	11.80	4.65	21.61	31.58	-15.30	14.06
<b>Cash from Operations</b>	<b>4,593.0</b>	<b>4,428.0</b>	<b>4,341.0</b>	<b>3,887.0</b>		
<b>Capital Expenditures</b>	<b>-3,122.0</b>	<b>-2,828.0</b>	<b>-2,367.0</b>	<b>-2,239.0</b>	<b>-2,367.5</b>	<b>-2,506.6</b>
<b>Free Cash Flow</b>	<b>1,471.0</b>	<b>1,600.0</b>	<b>1,974.0</b>	<b>1,648.0</b>	<b>1,323.7</b>	<b>1,597.7</b>

Source: Bloomberg

## **IMPORTANT DISCLOSURES**

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