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**The New York Times**  
ON THE WEB

December 24, 2001

## Hewlett Aims to Replace the Print Shop

By CHRIS GAITHER

**B**OISE, Idaho, Dec. 19 — Hewlett-Packard ([news/quote](#)) has pitched its proposed acquisition of Compaq Computer ([news/quote](#)) as a bold move to build a portfolio of computing systems and services to take on I.B.M. ([news/quote](#)) and Dell Computer ([news/quote](#)). It has argued that the \$24 billion deal would strengthen the company's sales of personal computers, data-serving computers and technology consulting.

But behind the deal is another Hewlett-Packard ambition: to extend the reach of its dominant printing and imaging division, which rang up \$20 billion in sales this year, 43 percent of the company's revenue.

In the last two decades, Hewlett-Packard built itself into the world's largest vendor of desktop printers. It had done so under the command of Richard A. Hackborn, now a Hewlett-Packard board member and a leading advocate of the merger. Today, at its 220-acre campus here in Boise, the company tests so many printers, inks and papers that, if one could stack up all the test sheets printed during an average month, the pile would reach 6,000 feet.

Yet, even with the company's market dominance, only 4 percent of the trillions of pages printed across the world each year are printed on desktop printers.


So now the company has a much bigger target: a piece of the other 96 percent, dominated today by the traditional offset press. The division's executives envision a world in which corporations print hundreds of thousands of customized catalogs and other reports on next-generation, high-speed digital presses from Hewlett.

The printer division is widely regarded as the company's crown jewel, but how Hewlett can best exploit it is a matter of dispute. Walter Hewlett, the oldest son of the company's co-founder, and other critics of the Compaq acquisition argue that the deal will dilute the printing business by burying it in an even larger, slower-moving computer company. The division's \$2 billion in operating profits this year propped up Hewlett-Packard's sagging computer business, which lost \$450 million.


Some analysts have advocated that instead of merging to become a larger company, Hewlett-Packard should pare down or sell off its other businesses and focus on selling more printers and imaging devices like digital cameras and scanners, which fuel sales of ink cartridges and paper.

The company, however, says it has no intention of narrowing its scope. Instead,

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proponents of the merger say the acquisition will fix Hewlett's computing business, freeing up more research and development money for the printing division to tackle new markets, like the \$400-billion-a-year commercial printing business.

"With or without the merger, this is the direction we really have to go," said Vyomesh Joshi, president of the imaging and printing systems division. "The current profit pools are in hardware and supplies. We need new profit pools in services and solutions."

To succeed, the company must win over not only the commercial print shops that would buy the digital presses, which cost \$200,000 to \$1.2 million apiece, but also their corporate customers. Promising to reduce printing costs and improve customer response rates, Hewlett-Packard will try to persuade corporations to fully digitize production and printing of their marketing materials — a process that, not coincidentally, requires new computers and services as well.

A hybrid of the corporate laser printer and the offset press, Hewlett-Packard's digital presses use technology developed by Indigo N.V. ([news/quote](#)), a Dutch press maker acquired for \$629 million in stock and as much as \$253 million in cash. Hewlett announced the purchase in early September, only three days after the Compaq deal was announced. The Indigo machine can quickly write, erase and rewrite an image on the film that transfers ink, all while the press spins.

By tying into broad computer systems, the Indigo press can link enormous databases of customer information with the printing process in ways that offset presses do not allow. While traditional presses are still best for large, uniform jobs, the Indigo press allows companies to print small-batch jobs without the start-up costs of offset presses, or large jobs in which each catalog is slightly different, tailored for a particular customer.

Hewlett-Packard wants to drive this transition to digital publishing, much as I.B.M., through a combination of products and services, helped businesses push into online sales in the late-1990's. If the strategy is successful, it would result in a surge in digital files that would stimulate sales of the powerful computing systems needed to create, store and move the files, as well the consulting and customer-service divisions that set up and maintain the printing systems.

To do that, Hewlett-Packard argues, it must become larger and stronger. The bigger it is, the more influence it will have on corporate technology managers.

"We can sit on the sidelines and let something like this happen, or we can be in the middle of it and move things forward," said Lee Caldwell, a former I.B.M. manager who is chief technology officer for Hewlett-Packard's printing and imaging division.

After two decades of working on laser and ink-jet printing, research and development engineers say they are excited to have a third printing technology to tinker with. Standing before an Indigo press recently at HP Labs in Palo Alto, Calif., several scientists pulled open panels on the machine, showing how they intended to incorporate existing Hewlett technology into it — features like automated cleaning, a less expensive laser system, better ink canisters and an integrated computer.

But Hewlett-Packard faces major challenges in cracking the commercial publishing market. Companies like Xerox ([news/quote](#)) and the leading offset press maker, Heidelberger Druckmaschinen, have created their own digital presses, and offset printing retains its technical advantages for large jobs.

Peter J. Grant, an analyst with the research firm Gartner Dataquest, called digital color printing very attractive to corporations, and he praised Indigo's technology as a powerful addition to Hewlett-Packard. But he questioned the ability of a newcomer — even one as potent as Hewlett — to lead the way.

"They may sell a few more printers, but nothing substantial," he said of the merger, predicting that it would create distractions across the printing and imaging division. "The downside is it takes resources away from the cash cow and funnels it toward less profitable or money-losing divisions of the company."

Hewlett-Packard executives acknowledge the risk but say they trust the team in charge of integrating the two companies if the deal goes through. Mr. Joshi, the printer division president, said the merger would help his division grow. First, he said, it will improve the company's chances of winning business customers with end-to-end computing systems, including printers. Second, Hewlett-Packard will displace its competitor, Lexmark International ([news/quote](#)), as the preferred vendor for printers through Compaq. Finally, he said he wanted other businesses to become stronger so the company would depend less heavily on printers and ink for profits.

But he acknowledged that if the computing and services businesses were not strengthened by the merger, the printer division could be left struggling to support a heavier burden. In a recent letter to shareholders, Hewlett-Packard predicted that if the merger with Compaq went through, the printer division would account for 27 percent of the new company's revenue — a smaller piece of the overall company than the 43 percent of Hewlett's sales contributed by printers in 2001.

If the computing businesses fail to recover as the deal's proponents predict, the printer division would have to offset heavier losses. But the company says that is a risk that must be taken, and the letter faulted Mr. Hewlett for assuming "that Imaging and Printing results can continue to support other businesses while meeting its own competitive challenges and reinvesting for growth."

While eyeing new markets like commercial publishing, Hewlett-Packard is also working to preserve its lead in laser- and ink-jet printing. Since its laser-jet printer hit the market in 1984, the company has sold nearly 225 million printers. Sales of print cartridges, among its most profitable products, have reached 250 million a year.

Though it supported other divisions, the printer business could not avoid the economic downturn last year, as sales declined 5 percent and profits fell 25 percent from 2000.

In Boise, engineers are devising new ways to fuel printing growth: software that lets personal digital assistants send documents to printers anywhere in the world, networked printers that allow technology managers to monitor toner levels over the Web, programs that spread the large-batch printing of paychecks and other single-page jobs across

several small, inexpensive printers.

"We need to make sure we continue to shine our crown jewel," Mr. Joshi said.

But Andrew J. Neff, an analyst with Bear, Stearns, said that Hewlett had spun off its testing and measurement unit as a separate company, Agilent Technologies ([news/quote](#)), because it did not receive the attention it deserved within the company. Expressing concern that the printer division might suffer the same lack of attention in a larger Hewlett-Packard, he said the company should pare down its computing businesses and work to extract more profits from printing.

"I don't know how acquiring Compaq helps the printer business," he said. "It seems to be a non sequitur."

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