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PRESENTATION

Katy Huberty - *Morgan Stanley - Analyst*

Let's go ahead and get started just because we only have 30 minutes. I'm Katy Huberty, Morgan Stanley's technology hardware analyst. And it's my absolute pleasure to welcome Cathie Lesjak, HP's CFO. Cathie has 24 years of experience at HP, so very much looking forward to the discussion.

While I read my disclosures, just please take a look at HP's disclosures up on the screen. Please note that all important disclosures, including Personal Holdings disclosures and Morgan Stanley disclosures appear on the Morgan Stanley public website at www.morganstanley.com/researchdisclosures.

So with that, thank you very much for your time today, Cathie. I wanted to start with a question that we actually talked about this time last year as it relates to the change in management. And I asked you what the impact was of Leo last year, and I want to ask you the same question on Meg. And this is an important first question, given that, you know, a cultural evolution is just as important as any cost structuring or business restructuring. And I just want to get your thoughts as to what the impact of Meg coming in as CEO has been on the culture and employee moral at HP.

Cathie Lesjak - *Hewlett-Packard - CFO*

Katy, I couldn't agree with you more. I think that the cultural aspects go hand-in-hand with investments you're going to make and costs that you're going to cut and how you're going to manage it.

And Meg is really very different than both Leo and Mark, in that she is extremely collaborative. And I don't mean consensus, and I'll talk a little bit about that. I mean collaborative. She wants to engage basically every member of the management team at her direct report level as well as lower in the organization.

So just to give you a sense whether it's we're talking about strategy, are we talking about kind of how to win a particular deal within the quarter or to make the quarter, the issues get put on the table, and there is a lively debate many times. I guess the whole decision around should we spin or not spin the PSG was a good example - great debate put on the table. Meg goes around and says, what do you think? What do you think? What do you think? And she goes around the entire table. Anyone who's sitting at the table gets a chance to say kind of how they would respond to a particular situation.

And then when I say it's not consensus, I mean it's not consensus. Meg looks around the table and makes the decision, and we move forward. And that is so incredibly important because it is bringing everybody along for the ride.

The feeling in the room today versus a year ago is everybody's all in. This really is about team Hewlett-Packard and striving to make Hewlett-Packard best, which is really important because we're going to have to make some tough decisions that means that we are going to maybe decide to deemphasize certain lines of business for other lines of business. So I think this is huge.

I think from an employee morale, broader employee morale perspective, Meg has hit the ground running. She is a very down-to-earth, very transparent individual. She does a tremendous amount of communication. One example that I think has been really important both to the team of her direct reports, but also to employees is that we all moved out of our offices - right now in temporary cubes, ultimately into permanent cubes in a couple of weeks. And the reason why that's so important is that there was only 15 or 20 of us who had offices in Hewlett-Packard. Everybody else lived in a cube. And the message that's been sent to the organization is we're in this together - we're no better, we're no worse than you are. And employees really like that and it helps with morale tremendously.

Katy Huberty - *Morgan Stanley - Analyst*

And have you already seen examples where the cultural impact has been able to help improve decision making, execution? You clearly just beat EPS.

Cathie Lesjak - *Hewlett-Packard - CFO*

Yes.

Katy Huberty - *Morgan Stanley - Analyst*

Well, you had to lower the bar, but you were able to execute and beat EPS this past quarter.

Cathie Lesjak - *Hewlett-Packard - CFO*

I have seen evidence of that. I think one of the really big pieces is when I come in my cube, and the walls are not very high, guys. They're about this high. You can see who else is in their cube. And instead of doing a bunch of e-mail exchanges to resolve an issue, you basically grab the person and you say, listen, I got this issue, can we resolve it quickly? And it's so much faster when you do it live than when you try to do it over e-mail. There's a lot of misunderstandings of what you meant or what you didn't mean. It just it really speeds up decision making, and I think it's overall positive.

And I will tell you that when Meg came back after the break because we moved into these temporary cubes, and she said, okay, Cathie, isn't this great? What do you think? I said, I'll keep an open mind. And I did, and it makes a difference.

Katy Huberty - *Morgan Stanley - Analyst*

You mentioned that some tough decisions will need to be made in the organization. We've seen in recent quarters the pressures that some of the secular industry trends are having on HP's revenues. And that argues to the fact that maybe the cost structure needs to be different, at least for some businesses, allowing you to reinvest in others.

Can you just talk generally about how is that process happening? What's the process that the management team is going through to decide where you cut, where you invest?

Cathie Lesjak - *Hewlett-Packard - CFO*

So I think that you really have to start with the overall kind of goal or objective. And that is really about setting HP up to continue its leadership position across a number of different areas for the long term. We talk about it being built to last or kind of in this position for decades to come. And that is really kind of a founding principle around whatever we are doing. And then I also think you've got to ground that with the customer and anchor it on whatever the customer needs today, how are they going to evolve over time?

And so we're working through kind of understanding the market evolution, thinking about where the opportunities are to basically make some investments that are leveraging the assets that Hewlett-Packard has today. But you can't just invest on top of the cost structure that we have today.

Revenue can't decline 7% and OpEx be up 6% for very many quarters. And so we absolutely have to take a hard, hard look at our cost structure, and we are doing that.

And some of the items are going to be very surgical. If we're deciding to deemphasize a certain line of business or product set, then obviously we're also going to take deeper cost cuts there - we will be surgical.

But there are also Pan-HP opportunities. We've talked a lot about the fact that we've got over $100 billion in cost structure. There is no way that that is even 5% -- or 95% efficient. There's real opportunities there. There's opportunities in supply chain. We've been executing on a supply chain initiative now for roughly three years. We have more to go. And when you layer on kind of the strategic areas, that also guides you to other areas to look at.

And then the other one is really the, quote to cash. And it's really about looking at process standardization, optimization, and then looking at that process and saying, okay, where can you insert automation. And the reason why that is so incredibly important is that you don't want your cost structure to have to grow in line with your revenues. And when you automate, you take people out of the process and you don't have to increase your cost at the same rate.

So there are huge opportunities in, quote to cash, in lots of different processes around the company. In fact, what we've done over the last few years is we focused so much on consolidating our IT datacenters, reducing applications from more than 6,000 applications to run Hewlett-Packard, today less than 2,000. So we didn't want to innovate on 6,000 apps. We want to innovate on less than 2,000 apps. And that's -- so the time is right to actually look at this process automation and really get some real benefits out of that.

So I think there's a lot of opportunities, and it's about surgically figuring out where you want to invest, and there -- where you can align the cost structure. But it's an absolute must for HP.

Katy Huberty - *Morgan Stanley - Analyst*

Over the past quarter, HP lost share in PCs, printers, servers, some of that was drive-related, and other factors impacting the business. But how do you think about this next year balancing market share and revenue growth versus profitability? Are you choosing one or the other?

Cathie Lesjak - *Hewlett-Packard - CFO*

At the highest level, we're choosing profitable growth. We want to set up our cost structure - think back to that last question that I just answered - in such a way that you can actually go after some additional share, but do it profitably.

But if you back up and you look at what happened in the first quarter, more than half of our revenue decline year-on-year came from hard disk drives. And based on the shortages that we saw, we prioritized profitability. We prioritized quality and product performance and aggressively, basically, allotted the drives that we had or that we saw that were coming to the more profitable segments of our business. And so that in and of itself is obviously a choice around share versus profitability.

So we're also setting this company up to have the right platform to drive profitable earnings growth over the long term. We've got to get the hard disk drive behind us. We believe that we will be largely through that by the time we start the second half. We also have other items that are putting pressure on profits in the first half that get alleviated in the second half, and that's really around some of the channel inventory corrections.

And so we start to see a much better picture in the second half as a result of that, as well as ramping our Gen 8 ProLiant servers. That's just starting to ship. Those have better AST. And then also just Autonomy. Autonomy has spent the first half basically getting to know HP, getting leads, qualifying leads, and it really starts to generate some revenue and margin synergies in the second half.

So those are really important aspects to kind of the configuration of our guidance first half versus second half.

And then the other thing I guess that I think is important is what we're not assuming, and that's that we're not assuming that the macro environment gets much better. We are expecting it to be pretty much the same.

Katy Huberty - *Morgan Stanley - Analyst*

Okay. Just to be clear on HDDs, since we talked a little bit about that, there were some investors that walked away from the various OEM quarters believing that HP got hit more than others in the industry. Do you think that's a fair characterization or do you think it was more the choices that HP made in the quarter?

Cathie Lesjak - *Hewlett-Packard - CFO*

I think it's a combination. If you actually look at hard -- there's a number of elements in what happened to our components. And depending on the mix you might have gotten hurt more or benefited more. So think about hard disk drive suppliers. They all didn't get hit to the same degree. And then you look at the different types of drives, and some drives were more plentiful than others.

Katy Huberty - *Morgan Stanley - Analyst*

Right.

Cathie Lesjak - *Hewlett-Packard - CFO*

If I can use that word in a shortage environment. But that's a big aspect to it. Where is your demand coming from? And then also, what kind of inventory did you start the quarter with? And if you look at kind of all those different components and you kind of mix them up, some definitely benefited more than we did.

We also had a couple other situations. One was we heavily use one disk drive manufacturer for some specific high-end drives, and they were hurt not just by the flooding in Thailand, but also other issues with their production facilities. And so we were differentially hit because of the reliance we had in those drive categories.

And then finally, HP, from a supply chain perspective, did not do as good a job as we would have liked with demand shaping, and making sure that we basically sold the drives that we had. And we've got to get much better at that. It's heavily influenced by the complexity that we've got in our supply chain, as well as the number of SKUs. So this is both an opportunity to get better at managing situations like this as well as to kind of go back to cost cutting, getting better at simplifying the SKUs and the platforms that we got in such a way that we save money.

Katy Huberty - *Morgan Stanley - Analyst*

Okay. I want to make sure we touch on a number of the business segments, starting with services. If you look at the operating profit margin over the past year, year ago you were earning 15% to 17% operating margin, this past quarter 10.5%. Can you talk about what the drivers were behind the compression, what you're doing to address that and where you think margins in the services business will level out longer term?

Cathie Lesjak - *Hewlett-Packard - CFO*

I think the first thing is that the margin or the performance that we delivered in Q1 was inline with the expectations that we set coming out of Q4, and I think that's really important. The revenue was up 1% in dollars and flat in constant currency. But the cost structure was up pretty significantly. And the cost structure increases were really driven by a number of items. The first is the investment that we're making in service delivery, building up our bench, and, frankly, investing into the transition that our services platform is going through to more what we call strategic enterprise services.

Those are services in the area of cloud, analytic, security, and application modernization. And we have got to shift the services business from being so ITO heavy to being more apps and BPO.

This is a pretty long-term journey, frankly. I think we called it a turnaround. It's going to take many years to get there. We believe we're making progress. But you saw margin compression, the combination of the investments we're making, as well as the fact that when you do renewals, you almost always renew at a lower price, the same business. And, frankly, in the services business, what really successful companies do is they're able to up-sell and cross-sell into more of these strategic enterprise services at the time of renewal, and then also be quick to adjust their cost structure.

In order for us to be able to do that, we really need to make some process improvements, which we're focusing on and we're making process investments as well as IT, because it's a lot around resource management, knowing what people are coming off of what projects, where they can be redeployed quickly and how you sell into that. So it really is this long-term journey [because] there's a lot going on from transitioning this business, less ITO reliance, and then even within ITO, less reliance on some of the service powers that, by the way, are very low growth and almost no profitability and high degree of dissatisfaction with customers. We've got to move off of that where we've got leading market share into more of the strategic enterprise services space where the margins are better and the growth is better.

Katy Huberty - *Morgan Stanley - Analyst*

Expanding the discussion to the rest of the enterprise business, over the past couple of years, HP has added several hundred senior accounting staff. Can you talk about whether you're yet seeing the payoff from the cross selling of those senior salespeople?

Cathie Lesjak - *Hewlett-Packard - CFO*

We have absolutely increased our sales force, and we focus both on the quantity, so we have added a lot, but also focused on the quality, and making sure that we've got the right folks and that we're training them. But we have not seen the sales productivity. And that's a big focus for us.

We think that we have the right set of portfolios, portfolio to sell. We've got a motivated sales force, and now we've got to get the productivity up. And there's at least three things that we are focusing on this year to help improve that productivity. One is kind of simplifying and making the messaging very consistent. So what are the key four or five solution areas that we're going to focus on that we want the sales folks to sell? And they are the same this year in 2012, as they were in '11.

We're also focusing on making sure that we've got the right selling unit. A selling unit isn't just a sales rep. It's a sales rep. It's some specialist. It's also some what we call technologist in the account, and being able to go to market with the right selling unit with the right mix. And we've got adjustments that we're making there. And then the final one is, frankly, simplifying our coverage model and our incentive plan. So there's a lot of work being done there, but it's absolutely critical. We have to get the sales productivity up.

Katy Huberty - *Morgan Stanley - Analyst*

Shifting to software, can you talk about why Autonomy made sense for HP versus any other large software deal? What synergy opportunities exist within HP? And then how do the benefits flow through the model over the next couple of years? What's the timing of that?

Cathie Lesjak - *Hewlett-Packard - CFO*

Yes. So if you look at Autonomy, Autonomy has actually positioned HP to be the leader in the next generation information management and analytic space. With the explosion of data, the ability for companies or customers of ours to basically be able to look at all this data, structured and unstructured data, and derive insights from it, is going to be incredibly valuable to companies going forward. And Autonomy has unique capabilities in the space, particularly around the unstructured data, which is the largest and fastest growing segment in the data segment. So this is a huge strategic advantage and directionally where we believe a lot of our customers and companies are going.

It has a real opportunity or we have a real opportunity to add value with Autonomy, across a number of dimensions. One is basically, if you look at Autonomy's revenue, roughly 82% comes from the US and the UK. So tapping into HP's global reach and go-to-market across 170 different countries is a huge opportunity. And we know how to do this. We've done this with 3PAR and we've done this with 3Com. It's basically put it through the big HP machine. That's an opportunity to grow the Autonomy business.

And then there are opportunities across a number of our segments to actually leverage the technology that Autonomy has - whether that's an ESSN in storage -- I mean, think about eDiscovery, backup, archiving, and the solutions that we can take some of the technology that Autonomy has and combine it in a storage business and come up with some really attractive and interesting offerings. Same is true in the software space across information management and security, making sure that customers feel secure with all of the, kind of the data that's available and they're mining.

And then I guess the other one that I would mention and call out is IPG. This is one where I think a lot of you have seen VJ before, when he gets passionate and excited, his eyes light up. And that is exactly, when you mention Autonomy, because he has been -- his organization has been really focused on this end-to-end document ecosystem, basically taking the strong positioning we have in management services and layering on top of it document workflow. And Autonomy has incredibly good technology that enables us to realize kind of that vision. And so we're really excited about Autonomy.

In terms of the timing, I mentioned that Autonomy, in the first half is focused more on kind of connecting to HP and getting the lead, and that the real revenue synergies start in the second half and basically ramp from there.

Katy Huberty - *Morgan Stanley - Analyst*

Speaking of the imaging and printing business, really for the first time last week you and Meg put on the table the idea that the business is facing some secular pressures and that at least right now the commercial printing business isn't growing fast enough to offset that.

Can you just talk more broadly about, A, do you think we're just starting to see the impact of the secular pressures and it gets worse from here? And, B, why isn't the commercial printing, the higher end businesses that you've invested in, growing fast enough? Is there something you can do to accelerate that and cover up what you're seeing in the core business?

Cathie Lesjak - *Hewlett-Packard - CFO*

I think first off, as you start at kind of the printing market. The printing market is maturing. And what's more typical in maturing markets is that they're more impacted by macroeconomic factors, things like global GDP, unemployment, the kind of business sentiments. And so there are those kind of cyclical components that are going to be important for the printing business, and we're seeing some of that.

But we're also seeing secular. And I think that, I'm not sure that I would agree that we've ever talked about this before in this way, because we have been seeing kind of secular headwinds, home photo printing, and we've talked about this before. But there's also a pretty significant secular tailwind. And this is really the conversion of analog pages to digital pages.

If you think about HP's offerings, we have no offerings in the analog space. So we don't make photocopiers, not in the analog sense. What we have is multifunction digital printers. And as pages move from analog to digital, that's an HP sweet spot. And we think roughly 200 billion pages are going digital every year, and we're investing into that.

It shifts, in many cases, it can shift where pages are printed, both from a consumer perspective, as well as a commercial perspective. And HP's been investing in that in Indigo, in Web Press. If you look at Indigo as an example, the pages printed on Indigo have been growing double digits. Typically high teens to mid-20-percent range year-over-year, quarter-in and quarter-out for many, many quarters. And again this last quarter, the impressions on Indigo grew 20% year-over-year. So we are definitely seeing that shift take place.

We're also investing more broadly in graphics as well as in the document workflow; solutions that sit on top of our manage print services, and we're seeing really good traction there. We also are investing in emerging markets and expect to get growth out of emerging markets.

Katy Huberty - *Morgan Stanley - Analyst*

Okay. I'm going to ask a couple more questions, and we'll leave time for at least one from the audience. Quickly on PCs, there's two issues that HP has dealt with over the past year, one more recent. One is market share in China. The second is starting to see some market share losses post the PC decision that was made, spin or not spin, a couple quarters ago.

Can you just talk about what the company is doing to regain its footing and its market share in those two segments?

Cathie Lesjak - *Hewlett-Packard - CFO*

Sure. In terms of the first one, the uncertainties that we created with the August 18th announcement around the potential PSG spin created a lot of challenges for HP, for its partners and for its customers. And so what we've been doing is we've got kind of the people on the ground around the world and in the PC space, spending a lot of time helping people to understand how deeply committed we are to the PC business.

We are working very closely with channel partners, because, frankly, this really impacted channel partners. We had our first-ever global partner conference a couple weeks ago, and Meg and the management team made a real point and made a good impression on the partners from the perspective of making sure they understood how incredibly important partners are to HP and how deeply committed we are to the PC business. And so I think that is going a long way to kind of settle that piece down.

On the China side, the China share position has not improved, in fact, has declined, as I'm sure you all are aware, and we're addressing that. And there's two big areas that we need to address with respect to China. The first one is really around slow-moving channel inventory. Part of that was created by changes in product sets, some bets we made on certain chips in products that we put into the channel that just didn't sell through. And we have made a -- done a good job in Q1 at getting that channel inventory down. It is now at the lowest level we've seen as we exited Q1 of our fiscal year than we've seen in years.

So the channel inventory is in great shape. But it's not just about channel inventory. The other piece is really around the channel partners that we've got in China. And this is where the August 18th announcement really hurt us.

If you go to some of the tier four, five, and six cities and you look at the channel partners there, these are small -- important, but small shops, that were exclusive to HP. And when we announced the potential PSG spin, they realized they needed to make a change, and so they did. They switched vendors fairly quickly. So we've got to earn back their trust and let them know how committed we are and how we're going to help them. And so it's going to take us some time to really get back that trust and build out that kind of those tiers of the channel partners.

Katy Huberty - *Morgan Stanley - Analyst*

My last question is on cash. The top priority, as you've said the last couple of quarters is to pay down the debt from Autonomy. But as you work through that, how do you think about balancing aggressive buyback, which you've done in the past, raising the dividend, which you talked about last year, wanting to do over time, and then making acquisitions?

Cathie Lesjak - *Hewlett-Packard - CFO*

The focus for fiscal '12, is rebuilding the balance sheet. And we are very clear on that point. We think that from -- when I use the term rebuilding, people always ask me, okay, well, what is your target? When I think about rebuilding, I think about getting back to at least where we were pre-Autonomy.

Katy Huberty - *Morgan Stanley - Analyst*

Okay.

Cathie Lesjak - *Hewlett-Packard - CFO*

With the cash uses that we see around CapEx, around dividends, around share repurchase to offset dilution from employee benefit plans, that is likely to take us almost two years to get back there. But we are very much focused on that.

Katy Huberty - *Morgan Stanley - Analyst*

Okay. Let me see if there's just one question in the audience. We have about a minute left. Back here? Yes?

Unidentified Audience Member

Two questions on the printing business. I appreciate what you're saying about the digital piece. Is that going to be sufficient [to actually] drive some top-line growth? And then secondly, more detail about competitive [interaction] and anything you'd like to sort of offer up with regards to yourselves versus Lexmark and the various parts of the printing business.

Cathie Lesjak - *Hewlett-Packard - CFO*

In terms of it being sufficient to grow the top line, over the long term, we expect that it will help us grow the top line. In the short term, we're obviously still adjusting our channel inventory levels and we are very much still in a soft consumer environment. I mean, if you look at the impact in consumer, to basically year-over-year in the first quarter, consumer was down 15%, and a lot of that was due to a soft consumer environment.

And so to really see what's going to happen over the longer term, you've really got to look at these macroeconomic factors that I talked about, because we are going to have kind of that element that's going to be driving a big piece of our printer business.

We do have great positions in the graphic space, and we'll be driving that hard. If you look at our graphics business in Q1 and management services as well, both of those grew double digits year-over-year, and so we've got to keep that up.

Katy Huberty - *Morgan Stanley - Analyst*

Okay. We actually have to wrap it up there. Thank you very much for your time.

Cathie Lesjak - *Hewlett-Packard - CFO*

Thank you.

Katy Huberty - *Morgan Stanley - Analyst*

Appreciate it.