

FINAL TRANSCRIPT

Thomson StreetEventsSM

HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Event Date/Time: Aug. 18. 2009 / 9:00PM GMT



Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

CORPORATE PARTICIPANTS

Jim Burns

Hewlett-Packard - VP IR

Mark Hurd

Hewlett-Packard - Chairman, CEO, President

Cathie Lesjak

Hewlett-Packard - EVP, CFO

CONFERENCE CALL PARTICIPANTS

Ben Reitzes

Barclays Capital - Analyst

Richard Gardner

Citigroup - Analyst

Bill Fearnley

FTN Equity Capital - Analyst

Tony Sacconaghi

Sanford Bernstein - Analyst

Katie Huberty

Morgan Stanley - Analyst

Shannon Cross

Cross Research - Analyst

David Bailey

Goldman Sachs - Analyst

Bill Shope

Credit Suisse - Analyst

Brian Alexander

Raymond James - Analyst

Shaw Wu

Kaufman Brothers - Analyst

Jeff Fidacaro

Susquehanna - Analyst

Keith Bachman

Bank of Montreal - Analyst

Mark Moskowitz

JPMorgan - Analyst

Doug Reid

Thomas Weisel Partners - Analyst

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the third quarter 2009 Hewlett Packard earnings conference call. I'll be your conference moderator for today. At this time, all participants are in a listen only mode. We will be facilitating a question and

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

answer session towards the end of the conference. (Operator Instructions). As a reminder, this conference is being recorded for replay purposes. I'd now like to turn the presentation over to your host for today's conference, Mr. Jim Burns, Vice President of Investor Relations. Please proceed.

Jim Burns - *Hewlett-Packard - VP IR*

Good afternoon. Welcome to our third quarter earnings conference call with Chairman and CEO Mark Hurd; and CFO, Cathie Lesjak. This call is being webcast. A replay of the webcast will be available shortly after the call for approximately one year.

Some of the information provided during this call may include forward-looking statements that are based on certain assumptions and are subject to a number of risks and uncertainties and actual future results may vary materially. Please refer to the risks described in HP's SEC reports including our Form 10-Q for the fiscal quarter ended April 30, 2009. The financial information discussed in connection with this call including tax related items 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 the fiscal quarter ended July 31, 2009. Earnings, operating margins and similar items at the Company level are sometimes expressed on a non-GAAP basis and have been adjusted to exclude certain items including amortization of purchase intangibles, restructuring charges and acquisition related charges. The comparable GAAP financial information and a reconciliation of non-GAAP amounts to GAAP are included in the tables and in the slide presentations accompanying today's earnings release both of which are available on the HP Investor Relations web page at HP.com. Finally, please refrain from asking multi-part questions during the Q&A and with that I'll turn the call over to Mark.

Mark Hurd - *Hewlett-Packard - Chairman, CEO, President*

Well, good afternoon and thank you for joining us. In the third quarter business continued to stabilize and Hewlett Packard continued to execute. We delivered revenue of \$27.5 billion and non-GAAP EPS of \$0.91, both of which exceeded the higher end of our prior guidance. We expanded non-GAAP operating margins by a full point due to efficiency gains in services and IPG. We generated \$3.9 billion of cash flow bolstering our strong balance sheet.

I'm pleased with our execution in a tough market climate. Our business in China accelerated this quarter above historical seasonality growing double digits over the prior year and leading the Asia Pacific region. The U.S. remained stable for the Second Quarter in a row but we've yet to see the same trend in Europe. The Technology Solutions Group has the industries best arsenal of hardware, software and services to manage and transform our customers IT environments. We are realizing the benefits of our own IT transformation saving over \$1 billion while doubling our IT innovation budget. Many customers I talk to have enormous opportunities to realize significant benefits and are turning to HP for help. This quarter share gains in key markets provided another proof point that HP is winning in the data center. We also realized sequential improvement in operating margins and services, ESS, and software. The services business, our largest segment expanded profits to \$1.3 billion and 15.2% of revenue. The profit performance was driven by productivity gains in Technology Services in addition to solid execution of the EDS integration which remains ahead of plan. EDS is making excellent progress merging work forces and processes while providing high levels of customer satisfaction. The EDS sales funnel is up double digits since we closed the deal as customers realize the power of HP plus EDS. We have removed over 16,000 of the roughly 25,000 we laid out at our analyst day. As our cost structure has become leaner and more competitive we have seen margins expand. Despite this progress we have significant EDS related cost synergies yet to be realized. ESS revenue declined 23% versus the prior year but improved sequentially led by ISS. This improved performance can be attributed to our largest ever server launch this spring. Our G6 servers can provide roughly a 12 month payback when upgrading from a G5 server and roughly a 3 month payback when upgrading from a G4 server. With an aging installed base of servers these economic benefits are hard for customers to ignore. And when IT spending picks up we would expect to see operating leverage in this segment.

The Personal Systems Group had another solid quarter, extending its market leadership by more than a full point. Revenue was fueled by China which grew significantly this quarter. With a new plant on its way in Chongqing, China's largest municipality

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

we expect to make further inroads into the high growth, western China PC market. Worldwide, consumer revenue continues to outperform commercial, fueled by the affordability and popularity of mobile products. Our mini notebooks are opening incremental markets and distribution channels. PSG delivered solid margins despite lower average selling prices and increasing commodity costs.

In IPG we continue to make good progress and I have strong confidence in our plan from an operational and strategic standpoint. There are over 200 billion pages shifting from analog to digital each year, which is a clear advantage for our portfolio. We have an unmatched ability to capture this opportunity and to grow our printing business as economic conditions improve. This quarter IPG further demonstrated the strength and resiliency of its business model. While reported supplies revenue was down 13%, sell out and constant currency was flat to slightly down as customers are spending roughly the same amount on our supplies as last year. An aggressive focus on the entire supply chain has driven channel inventory levels down from the prior year. With this improvement we can expect revenue growth for supplies in local currency to begin to accelerate starting next quarter. Our Inkjet portfolio is strong. We see increased opportunities for printer placements in Q4 and we made tangible progress in our retail photo and enterprise printing businesses.

Now before I turn the call over to Cathie to review the financials, let me reiterate the three reasons why I'm confident HP will emerge from the current market environment as a stronger force in the industry. First, our broad market leading portfolio. HP has scaled services, software and hardware, built upon open, industry standards that differentiate us in the marketplace. We understand customer needs and can deliver integrated solutions today. Second, our ability to leverage scale. Our scale provides us a sustainable competitive advantage and our efficiency opportunities are significant and ongoing. Third, our track record of successful execution. As this quarter demonstrates, we are executing in the marketplace, executing on the EDS integration, and executing on our cost initiatives. Our goal is to maintain our strategy through this economic cycle and emerge even stronger in the marketplace. By continuing to drive innovation, market coverage and customer support and invest for growth, we have the opportunity to create a meaningful competitive advantage for years to come. With that I'll turn it over to Cathie.

Cathie Lesjak - *Hewlett-Packard - EVP, CFO*

Thanks Mark and good afternoon, everyone. HP posted another solid quarter in Q3 fiscal 2009 and continues to demonstrate its ability to execute in both good and challenging markets. Our portfolio diversification, focus on innovation and operational excellence have enabled us to effectively deliver results to both customers and shareholders. Total revenue for the third quarter including the EDS acquisition, was down 2% year-over-year and up 4% in constant currency.

Looking at revenue by region, including the addition of EDS, Americas revenue increased 8% year on year, EMEA was down 12%, and Asia Pacific decreased 4%. Excluding the effects of currency, revenue was up 11% in the Americas, down 2% in EMEA and flat in Asia Pacific. Europe continues to be the most challenging region while Asia showed the largest sequential improvement led by growth in China.

Within Americas, the U.S. continued to stabilize. While we would like to see further stabilization in Europe we are encouraged by the signs we are seeing in the U.S. and China, which together represent more than 40% of total Company revenue. Gross margins for the quarter were 23.7%, down 70 basis points due to lower volumes in EFF, and the mix impact of ESS. Non-GAAP operating expenses for the quarter were \$3.5 billion, down \$547 million or 13% from a year ago. In addition to benefiting from the stronger dollar, this decline highlights both the work we've been doing to make our cost structure leaner and more flexible and the actions we have taken to improve our competitiveness in the current environment. Despite these reductions we continue to fund innovation, sales, and customer service at appropriate levels.

Non-GAAP operating margin increased to 10.8% up from 9.8% in the prior year driven by margin expansion in Services and IPG. OI&E expense of \$177 million was primarily due to interest on our EDS related debt obligations as well as currency hedging losses. All in all, we delivered solid non-GAAP earnings per share of \$0.91 in the quarter.



Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Now moving on to the details of our performance by business. Services including the addition of EDS delivered revenue of \$8.5 billion. On a year-over-year basis, operating profit in the quarter increased over \$700 million to \$1.3 billion, or 15.2% of revenue driven by improvements in both Technology Services and EDS. Drilling into the Services business, Q3 revenue was \$3.9 billion in IT outsourcing; \$2.4 billion in Technology Services; \$1.4 billion in Application Services, and \$711 million in BPO. We continue to win significant deals in both the public and private sectors most notably in the telecommunications and manufacturing sectors. As we approach the anniversary of the EDS acquisition, the integration continues to go well as we work to standardize EDS' processes with HP's.

Enterprise storage and server revenue was \$3.7 billion, down 23% compared with the prior year. Operating margin was 9.7% down year on year but up sequentially due to increasing volumes in ISS and supply chain optimization initiatives. While each of the businesses within ESS was down compared with the prior year sequentially ISS grew 14% as a result of strong customer demand for our newly launched G6 platform. G6 is the latest generation of Proliant server and incorporates innovations in software and power and cooling technology as well as the latest processors and chipsets. Business Critical Systems declined 11% sequentially reflecting a continued elongation of customer decision cycles. Storage was flat sequentially driven by stabilization in the Americas. Within Storage the entry level SAN products continued to do well and our LeftHand portfolio is benefiting from HP's scale and global distribution network.

HP software revenue declined 22% from the prior year to \$847 million. BTO and "Other Software" revenues were down 22 and 23%, respectively. Support performance remains solid, reflecting strong maintenance renewals and the sustained business value of our solutions. For the quarter Software operating profit increased to \$153 million or 18.1% of revenue. Personal systems delivered revenue of \$8.4 billion down 18% year on year and operating profit of \$386 million or 4.6% of revenue. Total shipments increased 2% year on year, with notebook unit growth of 19% offset by desktop systems declines of 13%. Average selling prices declined due to product mix, currency and a competitive environment. PSG continues to deliver solid performance and share gains driven by our innovative product portfolio and global reach including the expansion of our distribution in the telco channel.

Imaging and printing revenue for Q3 was \$5.7 billion, down 20% year on year due to the tough economic environment. IPG delivered operating margin of 17%. Compared to the Third Quarter last year, total printer units declined 23% and consumer and commercial printer hardware units declined 16 and 42% respectively. Supplies revenue declined 13%. Channel inventory corrections and currency accounted for most of this decline with sales continuing to be flat to slightly down. Within printing, we are seeing growth in key segments. Our Indigo press digital page volume grew 16% last quarter and wireless printers grew over 50%. In the enterprise our managed print services business had a number of competitive wins this quarter. Rounding out the segments, HP Financial Services had revenue of \$670 million down 1% year-over-year due to unfavorable currency and generated operating margin of 7.9% up 40 basis points from the prior year.

Now on to the balance sheet and cash management. We closed the quarter with a strong balance sheet increasing the total gross cash to \$13.7 billion and improving our net cash position by \$2.1 billion. We continue to manage our working capital very effectively with a cash conversion cycle of 18 days. Third Quarter days sales outstanding was 48, up 4 days from one year ago. Days payable was 55 days, down 7 days year on year. Owned inventory days were 25, down 10 days year-over-year. With regards to channel inventory each of our segments is within its target range. Compared with one year ago, ESS and IPG channel inventory were each down half a week and PSG was up half a week. Gross capex was \$1.1 billion up 30% sequentially. On a net basis capex was \$940 million, up 26% sequentially. Increased capital expenditures were primarily related to new IT outsourcing deal transitions such as Aviva and growth in our leasing business. Cash flow from operations increased 15% year-over-year to \$3.9 billion and free cash flow was \$2.9 billion. Share repurchases in the third quarter totaled \$1 billion or approximately 28 million shares. At the end of the quarter we had roughly \$6.1 billion remaining in the current share repurchase authorization. Finally, we paid our normal quarterly dividends totaling \$191 million. And now, a few comments on our outlook.

We are reaffirming the mid point of the full year outlook we gave you in May. Regarding the Fourth Quarter we expect our sequential revenue growth to be slightly below historical trends. We have gained significant share in PCs and x86 servers in recent quarters and while we are confident in the competitiveness of our products, we do not believe it's prudent to set investor



Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

expectations that we will continue to outpace the market at these rates and thus are modeling more modest share gains. In addition, we could face top line pressure due to the continuing weakness in Europe and the competitive pricing dynamics in that region. With regards to earnings, we expect OI&E expense of approximately \$0.05, a tax rate of approximately 21%, and weighted average shares outstanding to be roughly flat. With that in mind, we expect Fourth Quarter revenue to increase approximately 8% sequentially and non-GAAP EPS to be approximately \$1.12. We will be hosting our analyst day on September 24, where we look forward to sharing with you our plans for 2010. We will now open the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Your first question comes from the line of Ben Reitzes with Barclays Capital.

Ben Reitzes - Barclays Capital - Analyst

Thanks a lot. I appreciate that. I wanted to talk about printing supplies. You mentioned that printing supplies would have -- could you clarify your revenue outlook next quarter for printing supplies, it sounds like with currency it should only be down low single digits rather than down 13 and could you also talk about what the margin hit in the quarter was from the reduction of inventory, that maybe we don't see in upcoming quarters in IPG?

Cathie Lesjak - Hewlett-Packard - EVP, CFO

Thanks, Ben. In terms of supplies and our forecast for supplies, we expect it to be down less than it's been in the last couple of quarters so what we're calling for as long as currency stays in this range is that it will uptick a bit. There is still some channel inventory adjustments which I would categorize as fine tuning that still need to be done in that number.

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Yes, I think to your point that the customer if you will, the end customer is buying roughly the same amount of supplies as a year ago, when you look at end demand, so what we're getting now is less currency that's going to hit that number, so that's going to go down and we've corrected for the most part at a macro level we feel good about where the channel inventory is. We still have some tweeking to do in some skus and some geographies so I won't take you through all that detail so we still have tweeking but the bulk of what we needed to do from a channel inventory is behind us so I think we got another quarter of some correction and some currency but your points right. You're going to see another quarter of improvement on the supplies line.

Ben Reitzes - Barclays Capital - Analyst

Got it. You said next quarter it will be down at a less rate?

Cathie Lesjak - Hewlett-Packard - EVP, CFO

That's right. And I just want to remind you that we do have tough compares in Q4 because if you think about last years Q4 we had price increases that folks were stocking up in advance of and so if you look at Q4 growth last year it was about 11%, up 11% so we do have some tough compares in Q4.

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

But it will be a better number.

Cathie Lesjak - Hewlett-Packard - EVP, CFO

It will absolutely be a better number.

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

It will be a better number as we start working off the inventory and the currency starts to normalize and really the key thing for us is that end-user demand, the fact that people are really just simply printing as much -- buying as much as they were last year so we just have to get through the currency and inventory correction and we'll be going from there.

Ben Reitzes - Barclays Capital - Analyst

But isn't the margin artificially depressed at 17 if you were just cutting inventory wouldn't there be a margin benefit?

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Yes. The answer is yes, Ben. There is some of that. The flip of it is that as the demand is getting better for units you've got a reinvestment back into the units in the market so I won't take you through the balance, that math, because it's going to depend on what sku but at the same time we are seeing improved demand for printers and so for us getting more units out there is part of the model as well so I wouldn't Ben say just look at it singularly like we're going to see an improvement in the dollars coming through the supply side and we're going to get all that margin that's going to improve. Some will get balanced back as we put more unit placements out there that we think are coming and to be very direct on it we could have put more units out there in Q3 and we're going to be looking to put more units out in Q4.

Ben Reitzes - Barclays Capital - Analyst

Finally if I may, is the enterprise picking up Mark? It seemed like ISS really picked up at the end of the quarter and that's my final question.

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

I think I'll say one more time, I think what we've seen so far this year is what we'll see for the rest of the year. The only cautionary note I say is until I see the share numbers I can't tell you how much it's picking up versus our numbers are just picking up, so that's the only caveat I give you. I think we saw a little bit of improvement. Clearly the G6 launch was extremely successful for us. We feel very good about the TCO that we're offering customers. It's shown up as you've described. I just have to see the rest of the numbers come into see where the share numbers are to really feel like we've seen a change here.

Cathie Lesjak - Hewlett-Packard - EVP, CFO

And right now, one of the things we're seeing is that we gained more share than we thought we were going to gain and that suggests that we're just executing better and that the G6 platform is being very well received.

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Ben Reitzes - Barclays Capital - Analyst

Thanks a lot guys.

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Thanks, Ben.

Operator

Your next question comes from the line of Richard Gardner with Citigroup. Please proceed.

Richard Gardner - Citigroup - Analyst

Okay, thank you. Mark and Cathie, I wanted to follow on Ben's question regarding printer supplies. You mentioned that sell-through was flat year-over-year but you've done a couple of price increases which I think amounted to a total of roughly 10% price increase year-over-year, so we're down about roughly 10% in page volume. I was wondering if you could give us a sense of whether you're starting to see the page volume pick up at all within the core printer business and then maybe some thoughts in the early stages of a recovery about whether supplies or hardware will pick up first within the printer business?

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Listen, I'd be careful the way we model it and we think we have pretty sophisticated modeling process on this. When you look at the sell out, the price increase gets merged into the aggregate sell out environment so I think you can't take the 5% away twice if you will. The sell out neutralizes all of the price increases or promotions or anything like that gets neutralized in that sell out number, so we feel good, I think the way to say it would be we feel good. I'll add to it about the installed base, we feel good about the install base and we feel good about the page volume coming out of the install base. I think to try to put more color on it we've been cautious if you go back into Q1 to make sure we have the right alignment of supply and demand from a unit perspective but all through this the actual printing volume itself has looked quite stable to us.

Richard Gardner - Citigroup - Analyst

Mark, would you be willing to give us any sort of rough estimate on what page volumes what you think page volumes are doing in Inkjet and laser on a year-over-year basis?

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

I've got those numbers, I don't have them with me so I'll try to get our team to be able to give you something back afterwards but I don't have them in front of me, Rich.

Richard Gardner - Citigroup - Analyst

And then Mark quickly thoughts on whether supplies or hardware will pick up first within that business in the early stages of an upturn?



Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Well, supplies if you start looking at the data we look at and I'll let Cathie comment on it as well, supplies has really been pretty consistent through this entire environment and you have to look at it again ex currency and you have to look at it ex inventory correction and when you look at the data we get back from consumers printing is one of the least things they want to stop and when we look at our enterprise business we actually have the benefit of having major contracts with very big companies where we actually manage all of their printing and they give us annual estimates for how much they will print in a year and most of our customers are exceeding those estimates even in this economy of how many pages they're printing so from a supplies perspective it's been pretty consistent and clearly what people have chosen to do is not buy that incremental unit they would ordinarily buy in a good economy. So the way you asked the question, Rich, I think you're going to see units recover certainly quicker at a faster rate because of where they've been but again I think the supply -- that's only because the supplies market has been pretty steady through all this.

Cathie Lesjak - Hewlett-Packard - EVP, CFO

And when we think about the supplies market being steady we really look at what sell out has done on a constant currency basis and it's been roughly flat to slightly down the last few quarters.

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

So as we start moving back towards a single digit growth low mid single digit growth in supplies that just really comes we think with better GDP numbers, a little bit better employment numbers and you'll see that growth again on a local currency basis come back to where we described.

Richard Gardner - Citigroup - Analyst

Okay, thank you.

Jim Burns - Hewlett-Packard - VP IR

Next question please?

Operator

Your next question comes from the line of Bill Fearnley with FTN Equity Capital.

Bill Fearnley - FTN Equity Capital - Analyst

Yes, good afternoon Mark. If I could how should investors be thinking about the laser business here? Very weak unit growth this quarter, worse than last quarter and last year was an easier compare. Our survey work shows shortages on multiple skus in the VAR channel. Was this intentional on your part or how should we be thinking about the balance between hardware unit growth here and IPG margins overall?

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Thanks, Bill. Listen, I think overall we've had a case where as we aligned supply and demand, we were looking at the demand in Q1 and we've just really gotten through all of the Inkjet issues. We now have Inkjet supply and I know you asked the laser

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

question but I want to make sure I get all of the data out. Inkjet is in pretty good supply now and we have Inkjet units available which certainly recommended for you, Bill, personally as well. Laser side we have been, we're short on availability on some skus, so we've worked hard now to try to get some of these laser holes filled. The good news, Bill, to your point is demand is stronger than it has been so we've seen incremental improvement in demand. We've got to get the supply back up and to tell you where I think we are, I think we're going to be going through most of the Fourth Quarter with a couple of skus trying to fill that demand, so I don't think we'll be out of all of it until the end of Q4.

Bill Fearnley - *FTN Equity Capital - Analyst*

And just quickly, the shift to office jet from laser, how is that going? How is the office jet doing?

Mark Hurd - *Hewlett-Packard - Chairman, CEO, President*

Bill, one of the reasons we've had issues in Inkjet has been the success of office jet.

Bill Fearnley - *FTN Equity Capital - Analyst*

Okay.

Mark Hurd - *Hewlett-Packard - Chairman, CEO, President*

It's just been a very successful product for us. I think the team has done a really nice job with it, and again, the good news on Inkjet is we have now caught up, so good news is there's more demand, the bad news is we weren't perfect in filling it. We've got ink behind us and we've still got work to do in laser.

Bill Fearnley - *FTN Equity Capital - Analyst*

Thanks guys.

Jim Burns - *Hewlett-Packard - VP IR*

Next question please?

Operator

The next question comes from the line of Tony Sacconaghi with Sanford Bernstein. Please proceed.

Tony Sacconaghi - *Sanford Bernstein - Analyst*

Yes, thank you. Was wondering if you could provide any more color on leading indicators for the services business on the top line basis? Obviously the profitability story there is very very strong. You mentioned that the funnel has improved but can you comment at all on signings? I think from a revenue perspective you're down about 15% year-over-year pro forma this year versus EDS plus HP last year, so not too far off from IBM which I think was down about 11 or 12, but can you help us understand what year-over-year pro forma signings might look like or any other indicators about revenue growth in that business?

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Cathie Lesjak - *Hewlett-Packard - EVP, CFO*

Tony, what I would say is that we feel good about the signings. We're making progress, but as we said at the security analyst meeting in September, our primary focus over the last year has been really focused on getting the integration done and getting the cost synergies, because at the end of the day the leaner cost structure will enable the growth and we're getting to the point where we're starting to really focus on more growth and I think it's at that point in time that we'll have more color that we can provide on signings, either on a kind of trailing basis or on a quarter to quarter basis.

Mark Hurd - *Hewlett-Packard - Chairman, CEO, President*

You should think of it, Tony, as right at the pivot point where we've been doing a lot of work to get EDS integrated and it's gone, to your point, it's gone well for us in terms of being able to get done what we needed to get done and get the companies lined up. We've now got most of the legal entities or many of the legal entities now integrated with HP, we've got job architectures integrated with HP, we stay on track with the integration. The good news is we've been winning deals so the encouraging thing on a competitive basis we feel pretty good about our position in terms of winning deals. Our funnel is up and the acceptance is good.

I think to your point we're going to think hard about then, because we've had a number of milestones to your point we've been trying to nail over the course of the last 12 months as we integrate EDS, and we'll start thinking about now, as we go into SAM, what those next set of milestones are so that we can give you that kind of tracking you're talking about.

Tony Sacconaghi - *Sanford Bernstein - Analyst*

When you talk about moving on a pivot point, should we be thinking about obviously if you're a bit more aggressive in your share aspirations on a signings front, all else being equal doesn't that typically especially on longer term deals impact short-term profitability? Now I know there's a lot more savings coming forward you guys have talked about but should we expect your capture rate on savings going forward to the degree that you tilt more towards on offensive stance to lower?

Mark Hurd - *Hewlett-Packard - Chairman, CEO, President*

Yes, I mean obviously it's a longer conversation Tony, and to your point when you're talking about deals with five year horizons there's a portfolio of deals within it and first year deals are typically not as attractive as fifth year deals and you have to measure what your growth appetite is within the context of that portfolio. I think it's a better subject for us to lay out at SAM, than on the call but to your point that's exactly how we think about it, how much capital we want to deploy to drive what growth. I would tell you though as I mentioned earlier, there is, we have not captured all of the savings out of the EDS integration. We've done a lot of work but we have a lot of work left to do that we'll benefit from as we go out into future quarters so I think we've got more work to do on that front. We are pivoting to try to focus on more growth. I wouldn't think you should be thinking about it in terms of extremely dilutive to what you've seen so far because we've got more work to do on the profit line to begin with.

Tony Sacconaghi - *Sanford Bernstein - Analyst*

And then finally--?

Jim Burns - *Hewlett-Packard - VP IR*

Tony, we need to actually move on here. I'd like to ask everybody to refrain from asking multi-part questions please so let's take the next question.

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Operator

The next question comes from the line of Keith Bachman with Bank of Montreal. Please proceed.

Jim Burns - *Hewlett-Packard - VP IR*

You're on mute I think if you're there.

Operator

Sir your line is open.

Jim Burns - *Hewlett-Packard - VP IR*

Still can't hear you Keith. Let's move to the next question please?

Keith Bachman - *Bank of Montreal - Analyst*

Jim?

Jim Burns - *Hewlett-Packard - VP IR*

Keith, you're there?

Keith Bachman - *Bank of Montreal - Analyst*

Yes, sorry. I think my line was muted out but let me jump in. Just on services and I'll stick to one question, Mark you mentioned that there was cost savings away from EDS, and I think it was in the technology service area. I just want to try to get more color on what was the benefit of those margins, what drove those margins and is there more room to go away from EDS specifically?

Cathie Lesjak - *Hewlett-Packard - EVP, CFO*

Let me take that one Keith. So in terms of technology services we've been running our cost initiatives now for about a year and a half or two. We basically think about them in three phases. You get the jobs done in the right location, the lowest cost location where you can be efficient and then you next focus on getting your processes to be standardized and optimized and then obviously nirvana is getting them automated to whatever extent you can and we in the technology services plans we're kind of in that middle area where we're getting the processes standardized and optimized and so we think of that as being kind of middle innings for technology services and therefore we still have more opportunity on the cost of service delivery in that traditional maintenance business.

Keith Bachman - *Bank of Montreal - Analyst*

Cathie, I assume EDS was the larger driver of the services sequential change in profitability?

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Cathie Lesjak - *Hewlett-Packard - EVP, CFO*

On a sequential basis EDS was more of a driver, on the year on year basis they both contributed significantly.

Keith Bachman - *Bank of Montreal - Analyst*

Okay thanks very much.

Mark Hurd - *Hewlett-Packard - Chairman, CEO, President*

I think it's really a good question that we want to make sure you have clarity on and think of those technology services opportunities as when a customer has a problem, the real benefit that we can bring as technology Company is to resolve that problem with no human intervention and the cost structure is one dimension of it but I can tell you the cost to run a call physically versus running and dealing with a call remotely and dealing with a call even electronically has a tremendous cost delta and even customer satisfaction delta to the good when you can get that done. So the real beauty of technology services for us over the past several years has been yes, we've gotten the cost structure better but secondly, we've gotten the technology platform better so that we can resolve a bigger percentage of our customers problems with minimal human intervention, and at the same time improve the customer satisfaction with HP. So it's really all of those things that to Cathie's point you've got to get lined up together which is driving the improvement we've seen and to Cathie's point we've just got a lot more work to do and it's good opportunity for us.

Jim Burns - *Hewlett-Packard - VP IR*

Let's move on to the next question.

Operator

The next question comes from the line of Katie Huberty with Morgan Stanley. Please proceed.

Katie Huberty - *Morgan Stanley - Analyst*

Thanks, good afternoon. Even with the PC share gains slowing, revenue guidance appears conservative if we take your comments on demand stabilizing less volatile currency and even the server share gains were in the context of a very weak market that's starting to rebound and you've got the easy comp and printer supply so can you just drill into what is making you cautious on the revenue view for October? Is there something you're seeing in Europe or in the early days of back-to-school that's holding back the revenue performance next quarter?

Cathie Lesjak - *Hewlett-Packard - EVP, CFO*

Katie, I think the way to start is to think about what our revenue does typically sequentially and then take into consideration the fact that that sequential growth for HP without EDS typically 10 or 11%. With EDS, EDS comes in at kind of a low single digit seasonality and so that dampens obviously the quarter to quarter uptick in revenue and then you take into consideration the fact that Europe has been a very tough market, just generally and therefore, we usually see a very significant uptick from Q3 to Q4 in EMEA that we're just, we just don't think it's going to be as large. It's going to be muted and therefore you've got to take that away and the fact of the matter is from a currency perspective a lot of the currency tail winds sequentially comes from EMEA. Again, tough market, tough competitive pricing dynamics that said that's probably not going to result in a lot of top line benefit for us, and then finally to the point that I made in my prepared remarks is that we've gained a lot of share in PC and

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

servers and that's more share than what we had expected which suggests to us that the market is not as good as we thought it was.

Katie Huberty - Morgan Stanley - Analyst

But if we back out EDS, the core business would grow sequentially closer to that 10% range?

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Closer.

Cathie Lesjak - Hewlett-Packard - EVP, CFO

Closer, with these adjustments for EMEA, you get pretty close. I think the other thing to remember is that if demand is better than we're calling for, we're thinking it's going to be, we're very well positioned to take advantage of it.

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Yes, I think Katie, first of all I think you're exactly right with what you're saying and the non-EDS sequentials are pretty close to historical seasonality but a little short of that based on the points that Cathie raised and I think for us, we'd really would like to see more strength in the overall market in Europe and the currency uptick you see, it's a good thing. It's a good thing. It's in a market that's already got its other issues so I think we just think it's prudent to see how this plays out and again the share gains we feel good about. It's just that when we think the market is strengthening sometimes we get a bit muted when we see the share gains that are just bigger than we projected.

Katie Huberty - Morgan Stanley - Analyst

Got it. Thanks for the clarity.

Jim Burns - Hewlett-Packard - VP IR

Thanks, Katie, let's take the next question, please?

Operator

Your next question comes from Shannon Cross with Cross Research.

Shannon Cross - Cross Research - Analyst

Thank you very much. Mark, could you talk a bit about how you're thinking about just in aggregate share gains versus margin within the product categories? How you're thinking about ASPs, printers, PC storage, servers, et cetera, just maybe an idea of how you kind of look at it as you get a bit more this quarter what you're thinking about going forward just so we know how you're sort of balancing things?

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Yes, again, I think we've not built models, Shannon, to try to have large share gains. These are not and we typically don't go into a quarter saying, let's try to gain this much share, let's try to do this. We try to build our models to your point to optimize multiple issues, and that's why I think like you hear Cathie and I keep talking about the share gains because I'd say they surprise us a little based on the way we've been pricing. We have not been doing intentionally anything from an aggressive pricing perspective in this economy because to a large effect, there isn't as much elasticity as you would see in a good economy, so for us, we've been trying to balance the answer. Now we've got other things going on in ASPs too and we have new entrants in the market so when you add the fact that we earlier we've introduced an office jet, we've introduced a mini notebook, we've moved into several adjacencies that have some impacts on the ASPs as well but at the same time they've given us incremental market opportunity as well, so we're trying to balance all of those things and I would say think of us as being from a pricing perspective, Shannon, we're trying to be steady as it relates to our impact on the pricing side. That steady approach has led to more share than we thought we would have.

Shannon Cross - Cross Research - Analyst

Okay, great. Thanks.

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Thank you.

Operator

And your next question comes from the line of David Bailey with Goldman Sachs. Please proceed.

David Bailey - Goldman Sachs - Analyst

Great. Thanks a lot. With a lot of the EDS integration behind you and demand beginning to stabilize in most of the geographies, are you looking to increase your buybacks or get more aggressive on the acquisition front given the cash flow that you're generating?

Cathie Lesjak - Hewlett-Packard - EVP, CFO

We feel great about our cash flow this year. \$5 billion last quarter, \$3.9 billion this quarter, and expect to have healthy cash flow in Q4. One of the things we talked about at the security analyst meeting is we wanted to get back to a positive net cash position within 12 to 18 months of the acquisition and EDS, and we've made good progress, improving our net cash position by \$2.1 billion this quarter gets us closer. We've got a negative cash position of \$3.2 billion so we still have a little bit of work being done so in terms of buybacks because of that we have moderated our buyback with the focus continuing on making sure that we cover dilution from employee benefit plans and then buying a little opportunistically, kind of when we get through this, I think we'll relook at what we're doing from a share buyback perspective.

Operator

Thank you your next question comes from the line of Bill Shope with Credit Suisse.

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Bill Shope - *Credit Suisse - Analyst*

Okay, Great. Thanks. There have been some concerns that recovery for PC and server OEMs would be at least partially muted in the near term by rising component prices and potential shortages. Can you give us your view on where you think the key pain points are in this respect, how they may evolve into the peak season in the second half and how you're managing this with strategic inventory management or other methods?

Mark Hurd - *Hewlett-Packard - Chairman, CEO, President*

Hi, Bill. It's Mark. We saw pricing and supply pressures on memory and LCDs a bit in Q3 so that was contained in the results that we've given you. We think some of that will continue on certain commodities into Q4, so we know how to navigate these situations pretty well to your point. We view our procurement team as a real competitive advantage. We think we do a good job in these type situations and actually typically tend to do a little better when these situations occur, so but that's what we saw.

Bill Shope - *Credit Suisse - Analyst*

Okay, thank you.

Mark Hurd - *Hewlett-Packard - Chairman, CEO, President*

Thanks, Bill.

Operator

Your next question comes from the line of Brian Alexander, with Raymond James. Please proceed.

Brian Alexander - *Raymond James - Analyst*

Thanks, in ESS, Mark, you highlighted leverage in the model and if I look sequentially your contribution margin in ESS was north of 30% after backing out the Cornell charge from last quarter with ISS driving all the growth which is presumably lower margin than BCS and storage so how should we think about leverage going forward in ESS? Can you keep contribution margins well above 20% for a while or anything unique in the quarter that we should know about?

Mark Hurd - *Hewlett-Packard - Chairman, CEO, President*

Well, I'd really like to no comment that. I think that your math is sort of roughly right. I'll leave it at that. I think we'll just have to see again, we'll have to see first how demand goes and if demand goes, I think it's fair to say that we think we have leverage in this business, yes.

Cathie Lesjak - *Hewlett-Packard - EVP, CFO*

And I would say there was nothing particularly unique about this quarter once you take out the adjustment that you took out for Cornell in the compare.

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Brian Alexander - *Raymond James - Analyst*

Thanks.

Operator

Your next question comes from the line of Shaw Wu with Kaufman Brothers. Please proceed.

Shaw Wu - *Kaufman Brothers - Analyst*

Okay, thanks. Mark, just a quick question on your networking business. Any color you can provide there and also on the competitive environment, and then last just on your virtual technology that you're doing there? Thanks.

Mark Hurd - *Hewlett-Packard - Chairman, CEO, President*

Sure. I think that it's a good quarter from a competitive market position we think they did well, virtual connect of course is an important product for us because it's actually, in our server business, our opportunity to virtualize the number of network connections so think of us playing to your point both ends of this, both trying to virtualize the number of network connections that a customer needs and secondly being with our edge products and our wireless products to be very active in the networking market and we feel very good about the acceptance of Pro Curve and the relative position of Pro Curve in the market.

Cathie Lesjak - *Hewlett-Packard - EVP, CFO*

I'd add-on that from a preliminary perspective, it does look like we gained share again this quarter, roughly a point.

Shaw Wu - *Kaufman Brothers - Analyst*

Okay, thanks.

Mark Hurd - *Hewlett-Packard - Chairman, CEO, President*

Thanks.

Operator

Your next question comes from the line of Jeff Fidacaro with Susquehanna. Please proceed.

Jeff Fidacaro - *Susquehanna - Analyst*

Great. Thanks for taking my question. Mark, just wondering if you take a look particularly in the PCs and ISS and the share gains, and can you discern for us the difference between the share gains and actual market demand turning around as you look into 2010? In other words is IT spending where you talk to your customers looking to pick back up and where would you look to see that first?



Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Well, when you say see it first I'll tell you I think right now what is a very important time in the market because from an enterprise perspective, most of our customers are now doing the planning for 2010 and we expect that 2010 will be a better year than 2009. I think the important thing will be how customers choose to spend that money. A couple of things Jeff that I think are important is that customers have user bases, if you will, that are aging and they've deferred a lot of infrastructure spending because of the economy. At the same time many of our customers deferred innovation spending for the same reason so they are going to have to deal with not only what is the scale of their IT budget in terms of year-over-year but secondly, how to break that up in terms of the replacement of infrastructure from structure they are looking at very attractive TCOs with things like the G6 et cetera. In addition to what they do from an innovation and project perspective and that obviously relates back to our services business and some of the work we do in ap services so I think right now customers are deciding where they're going to go and my guess is you're going to see a little bit of both. You're going to have to see an improvement in the innovation budgets out there and you're going to have to see some necessary refresh of the infrastructure.

Now I think one other point I would tell you is that the installed bases of infrastructure that will be replaced in 2010 is installed base that was sold many years ago, not the installed base that was sold in 2007, 2008, 2009, so one of the big issues for us is what share position do we have? Our share position now is stronger than it was in the past so we'll be competing against many incumbents non-HP installed base that will come up forbidden 2010 so we'll have to see how we fare.

Jim Burns - Hewlett-Packard - VP IR

Great. Thank you. Let's take the next question please?

Operator

Your next question comes from Mark Moskowitz with JPMorgan. Please proceed.

Mark Moskowitz - JPMorgan - Analyst

Yes, good afternoon, thank you. Real quickly here, Mark, in terms of all your models you have internally what do you hear from your salesforce if you're able to qualify the impacting stimulus activity I think over in China and how much of that is really impacting the consumer versus the corporate customers interface over there?

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

We think it's very positive. I think the stimulus package on the consumer I think is, we mentioned this Mark even in Q2. We saw an improvement in Q2 in China after the consumer stimulus was released and we saw that continue into Q3. We've additionally seen help in the corporate projects that have been helped as well so in China, the stimulus package is both from a corporate perspective and a consumer perspective, we've seen directly get into the market and certainly help the business.

Mark Moskowitz - JPMorgan - Analyst

And then as a follow-up I was curious on the corporate side, I heard your comments about 2010 in terms of infrastructure versus innovation. I was curious in terms of the near term you talk about some signs of stabilization. Where does the RFP get layered and are you starting to see RFP starting to tick up as some of the customers who have not been buying or is it just kind of maintenance upgrade?



Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Yes, Mark, I think that again depends very much on the region that we're talking about and again I want to make sure I'm clear in de Lynne rating in Q1 which was our of course November, December, January, we saw a very consistent set of results across the world in terms of countries and segments. We saw that change a bit in Q2 and we saw it change yet more in Q3 so for us, it depends where you're talking about. The U.S. is beginning to do refresh work and you're seeing that show up in the numbers. Things are still not as robust in Europe.

Jim Burns - Hewlett-Packard - VP IR

Great. Why don't we take one more question, please, operator?

Operator

Yes, and your last question comes from the line of Doug Reid with Thomas Weisel Partners. Please proceed.

Doug Reid - Thomas Weisel Partners - Analyst

Thanks for taking the question. And my question is on the handset opportunity. I wonder if you could share with us what you may have learned from your experience with netbooks that may make you more or less likely to make a bolder move into handsets?

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Well, I won't talk about anything about that handset because we obviously have a handheld business today, but the netbook opportunity, as we call mini notebook opportunity has been pretty positive for us. It's opened up not only incremental market for us but it's also opened up an incremental market through an incremental channel, so when you look at what's gone through the telco channel, this is a channel that frankly, has not been in this market before and our success with some of the early launches in that channel have been pretty favorable. The other piece that I think is important is because of the resiliency of our business model in PSG, we can do it at roughly the same margins that we do the rest of the business, so it's an attractive adjacency for us and we believe we're getting to a new set of buyers. I won't say they're all incremental buyers but certainly some percentage of them are incremental buyers so we're generally favorable on it.

Doug Reid - Thomas Weisel Partners - Analyst

Great. Thank you.

Mark Hurd - Hewlett-Packard - Chairman, CEO, President

Listen, thanks everybody for joining us. I think the way I'd summarize for us is in the quarter was solid for HP, relative to our expectations going in, certainly we beat the top line, we beat the bottom line. I think the cash flow, margins being up 100 basis points for us and the strength of the cash flow and I think to Cathie's point we've generated almost \$9 billion in cash flow in the last two quarters was very strong. We're encouraged I think by the stability that we're beginning to see in the market but not yet at a point that we're ready to call it a turn. I think we've seen improved stability and we feel good about that. We're confident in the outlook that we've given you today and I think probably more importantly, confident that the potential we've got when this economy does fully turnaround that we're well positioned to take advantage of it. So with that, I appreciate all of you taking the time to spend with us this afternoon.

Aug. 18. 2009 / 9:00PM, HPQ - Q3 2009 Hewlett-Packard Earnings Conference Call

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect and have a great day.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2009, Thomson Reuters. All Rights Reserved.

