

FINAL TRANSCRIPT

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PRESENTATION

Chris Whitmore - *Deutsche Bank - Analyst*

This is Ann Livermore. She runs the enterprise business or the TSG Group for Hewlett-Packard. Perfect timing, Ann. It's great for you to be here today as you embark on the EDS acquisition. I think you are going to open up with some slides and then we will do the Q&A from there.

Ann Livermore - *Hewlett-Packard - EVP, Technology Solutions Group*

Yes, I'm going to spare all of you the charts and only show you one today in addition to our typical legal disclaimer. And as my boss, Mark Hurd, likes to say, we are really smart about the past and anything we say about the future might be wrong. I think that is in legal terms what this says. But I am sure during the course of the dialogue will make some discussions about comments of things we expect that are forward-looking as well, which clearly might not be as accurate as what we know about the past.

A quick overview just to make sure all of you are comfortable with the parts of Hewlett-Packard that I know the most about or are most responsible for and that is what we call our Technology Solutions Group. This business includes our enterprise servers and storage. It includes our HP services business and also our HP software business. If you were to look at this set of businesses in our last quarter, it represented 37% of HP's revenue and it represented about 45% of HP's profits. So it's a series of businesses that make a nice profit contribution to the Company.

The revenue for those three units, which are each reported as their own separate segment, was \$10.3 billion. So it was a nice year-over-year growth of about 11%. As you can see in the chart at the bottom, while the revenue for those groups of businesses grew 11%, the operating profit was up 27%. So some nice improvement for us overall in the business models associated with those segments. We will talk throughout the Q&A discussion about each of these businesses.

Our server and storage business, we feel good about the position we have with our product lineup and also the growth in some of the segments inside that business. Of course the fastest-growing segments being inside our storage business, which grew last quarter at 16% and inside our blades business, which continues to be quite an aggressive growth area for us. It was a 66% growth, so some very fast-growing segments inside overall a business segment that grew about 5% and a nice profit contribution.

Our services business, really good growth, 14% growth last quarter. Our outsourcing business grew 18% and our other two segments are consulting and integration and our technology services, which are our maintenance type services, each grew 13%. It was the best quarter we had ever had in our outsourcing business, so we are feeling great about the position and strength of HP's outsourcing business as we are moving into the EDS integration activities.

As you can see, a really great profit improvement year-over-year in our services business in terms of the 2.1 points of profit improvement and a great multiple, if you look at the profit growth of 14% revenue growth and 38% profit growth in the services business. Similar improvements year-over-year in our software business. Nice revenue growth at 29% and a really strong operating profit improvement in terms of the points of improvement year-over-year inside that segment. So overall a strong quarter for us.

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We are pleased with the progress we have made and yet at the same time we believe there is still lots of improvement we can drive in this business, both in terms of the growth in some of the segments as well as some of the continued operating profit improvements as a result of cost improvements that we will make.

That is all I will say to start it off, just to give you a grounding for our last quarter. As you know, we are six weeks into our current quarter associated with it and I look forward to having the rest of the session in a more informal Q&A basis.

Q - A N D - A .

Chris Whitmore - Deutsche Bank - Analyst

Great, thanks a lot. I think the number one thing on most people's minds is the overall states of IT spending on a global basis. Can you provide any color as to the trends you are seeing with respect to IT spending budgets in the US and Europe and Asia Pac?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

Yes, well, as you can expect for a company like HP, we have got a variety of segments that we deal with, so it's hard to give just one answer in terms of how the performance is. If you look across our segments, we have our consumer business, our small medium business, our enterprise business. Then across the geographies, we only have 32% of our revenue that is inside the US and 19% in Asia-Pacific, 40% in Europe. So quite a geographic spread to our portfolio, as well as an industry spread in our product spread.

If we look specifically at the US, in our last quarter the US grew 2% and that was actually an improvement for us from the prior quarter. Our Q2 was minus 1%, last quarter was 2%. Still the slowest growing of our geographies from the big geography perspective, but it's a 2% growth. At the same time, if we look at the BRIC countries for HP last quarter, they grew 24%, so still nice growth in those geographies.

We are not seeing a strong pattern. You know, if we look in Europe, our Europe performance in Q3 was about the same as it was the prior country -- the prior quarter. But inside of that we had some countries that were down and some that were up quarter-to-quarter in terms of the overall trends associated. Certainly, as you looked across parts of our product portfolio, we saw very good demand that we are not sure all of our competitors saw as strong a demand.

Chris Whitmore - Deutsche Bank - Analyst

Looking forward over the next three to six months, what are your expectations in terms of constant currency growth for your business going forward? I think if you back out currency probably about 5% organic last quarter. Do you expect that rate of growth to -- do you think that is sustainable over the next six months or so?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

We always talk and think inside of HP in planning purposes around [comps] and currencies, so when we build our own business models inside we are always working them from a constant currency perspective. Our guidance isn't any different than what we have seen associated with it because we are looking at in terms of constant currency.

So we are not really projecting any difference from a constant currency perspective. Then we will see what the currency is doing as we look at the euro at 141, 142, there is certainly a lot of shifting happening.

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Chris Whitmore - Deutsche Bank - Analyst

So in terms of that underlying demand growth rate, do you see any signs of weakening on a global basis? Or do you think that the current growth rate is sustainable?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

What we see is, like we were mentioning, very different demands depending on the business area. We see tremendous customer interest right now around anything that we can do to help them flip the ratio of their spending so that they can take less out of operating their current environment and put more into innovation. So things that we do like our software, our IT management and automation software that takes labor costs out of running IT, very strong demand for that.

If you look at the cost of operating a data center today, one-third of the cost is the labor cost and they spend two-thirds of all their costs just managing and operating stuff. So anything we can do to take the costs out there so that our clients can either save money that goes to their bottom line or reinvest it into other parts of IT that drive innovation, that has got a huge demand.

We see a strong demand for outsourcing because there are a lot of companies who are interested in getting the cost savings that you can get on a guaranteed basis through an outsourcing contract or the balance sheet advantage you can get from an outsourcing contract. We see strong demand for storage.

Last quarter our storage business grew 16%. In the mid-range and low-end of the storage business for us our EVA and MSAs grew 19% and that is more of a reflection of content inflation, people wanting to do stuff with all the information they have for competitive advantage.

So what we see is that those products and services that can enable a company to drive down costs or do something that has a clear revenue payback, there is demand for it. And other stuff is certainly lower down the list.

Chris Whitmore - Deutsche Bank - Analyst

You mentioned blades previously, blades enjoying very strong growth, but overall x86 revenue growth was arguably somewhat disappointing despite the strong units. So help me understand the mix dynamics within x86 and are you seeing a slowdown in overall x86 demand or is this a pricing issue?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

Yes, if you look inside the x86 business, it's interesting because we all used to just talk about it as the x86 business. But now inside of those portfolio server sales there is actually quite a few different segments.

If you look at blades, the blade growth is very strong and the demand is very strong. The other thing that is attractive about blades, if you look at the IDC information, IDC will say that the average selling price for blades is about \$1,000 more than a rackmounted solution. And so you've got blades with positive ASPs, positive margins growing really fast.

Then you have got the low end of the business what we call scalable infrastructure, what some people think of as the servers that get sold into the cloud services type environment. So the kinds of deployments that a Facebook or a Yahoo! or an eBay or a Microsoft might do. Those are very skinny servers, very cheaply configured, and the resiliency and the reliability moves up to the application layer for the way they have designed their applications. Those are very low-cost servers with very declining average unit prices and then the more traditional rackmounted.

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So you put you put it all together and it's quite a different blend of things. So it's depending -- the margin profiles that you see us and some of our competitors have and the revenue and unit growth differences are a reflection of all of those things; but clearly, tremendous volume at the low end of that market.

Chris Whitmore - Deutsche Bank - Analyst

Server virtualization is obviously a key trend. Have you seen any change in the rate of adoption of server virtualization?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

It's interesting. One of the things we are seeing with a lot of our clients is that they have piloted virtualization in an area or have begun doing some virtualization. We just did a survey of a whole series of customers on an international basis and what they said was they expected -- 89% of them, so almost 90% of them, expected to only have virtualized 25% of their environment by 2010.

The thing that is slowing down a lot of companies doing the virtualization is the complexity they are running into. What they are finding is that they have got the mixed environment with the servers. Many of them have multiple hypervisors so they may have a combination of Microsoft and VMware and Citrix deployed. We believe that is going to be the case.

What the demand is for now is products that have been designed to operate well in a virtual environment, so that is one of the things HP has been focused on. The other is the management software to manage your virtualized environment when you have got part of your environment virtualized and part of it still physical. So the management soft there is a huge sweet spot for HP because of what we have invested in with all of our IT management and automation software.

So those are the kinds of things that we are seeing. We are seeing people stopping and grappling with the question of, gosh, how do I manage this thing now that it's halfway virtualized? I also got the old stuff to handle as well.

Chris Whitmore - Deutsche Bank - Analyst

Does the budgetary constraints and the fact that a lot of customers who deploy server virtualization didn't upgrade their servers a bottleneck or are they willing to spend on the new servers to drive it?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

Well, there is not any question that in a virtualized environment you need fewer servers. Everybody has been saying that and that is true. But what we see people tend to do is buy more richly configured servers.

Also part of the reason you see so much growth in blades is often as people are doing the server changes to move to a virtualized environment, that is when they go to blades. So we feel like a big part of our success with our blades growth ties to the virtualization aspects, how well those systems are built to operate well in a virtualized environment.

Chris Whitmore - Deutsche Bank - Analyst

One more virtualization question. The 25% number by 2010, where do you think it is today?

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Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

Well, it's obviously less than that. I don't know. You see different things. What we see is a lot of people have taken a particular application environment where they wanted to upgrade the application and needed to upgrade the servers. I would guess it's probably more like 10% or 15%. It's just -- it's in that range. It's just still a very, very new opportunity.

Chris Whitmore - Deutsche Bank - Analyst

I'm going to completely shift gears and ask you about EDS.

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

Yes, what is the price? You've waited (multiple speakers) --

Chris Whitmore - Deutsche Bank - Analyst

Yes, moving on to EDS. Can you talk about -- Mark talked about operating cost synergies and revenue synergies. I wanted to discuss both. Perhaps you can give us a sense as to where you see the greatest opportunities for cost reduction. Is it labor? Is it real estate? Is it benefits? And how do you implement those operating cost savings?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

Well, as many of you may know we are scheduled for Monday the 15th, so just a few days from now to have a whole analyst meeting where we are going to go through in detail the financial plan for '09 and what we are planning to do from both a revenue and cost synergies perspective. So all the details will be shared on Monday associated with that.

But we have had in our clean room our integration planning team, 500 full-time people and 500 part-time people doing very detailed integration planning activity and everything you have talked about are the things we have looked at. So we have looked at all of the corporate wide functional areas, certainly all of the areas you mentioned and have detailed plans as to what we will do in every area in terms of what the opportunities are there.

I can't give any specifics today because that will be what we disclose on Monday, but the thing we feel very good about is that we feel very confident that there is a lot that we can do associated with it. We feel good that we have got very detailed plans and playbooks that we are distributing to the EDS leaders and the HP leaders in charge of each of these areas.

We have already defined the management at Ron Rittenmeyer's level, who is the CEO from EDS, who is leading the entity. We have defined his staff, we defined the managers the next level down, and as well the corporate function. They all have their plans and goals in place and are beginning to execute against some very detailed plans.

Chris Whitmore - Deutsche Bank - Analyst

How will the combined services business and your group, the TSG group, interoperate on a go-forward basis? How does that relationship develop over time?

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Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

What we are doing is we are taking the outsourcing business that had been part of my team and moving it into the EDS structure, so that we have one outsourcing business for the Company. It's going to structure directly reporting to Mark, led by the man who has been the CEO of EDS.

We are also taking some of the application services work that has been part of my services team and moving it into EDS, because they have a very large applications outsourcing and applications services team. So it makes sense for us to have those together.

My team will work with EDS just as if they are another services partner. The EDS team will have incentives to cross-sell the HP products, not just in my portfolio, but our PCs and our printers as well. So we will have an opportunity for product cross-sell. Certainly, my support organization that provides support around all these products already does some work with EDS even before EDS was part of Hewlett-Packard. So we have a great opportunity for them to continue and grow that work as well.

Chris Whitmore - Deutsche Bank - Analyst

I would imagine you work pretty extensively with all of EDS competitors as well. Can you comment on any backlash or any -- if there is any resulting from the transaction?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

As you can imagine, we have had very detailed phone calls with all the large systems integrators and outsourcers who are in the industry. Even when HP had our own outsourcing business, which of course is smaller than what we have now with the combination of EDS and HP, we had relationships with all the big systems integrators. If you look at CSC or Accenture, Capgemini, you go down the entire list and we want to maintain all those relationships.

In fact, there is no better outcome in the world for HP than on every bid to have HP products involved in the bid and to have those teams continuing to include in their bids HP technology, HP services, where it doesn't compete. We put in place what we call clean teams. We have a firewall between the teams, so we have people who all they do is work with Accenture or with CSC and their whole livelihood of sales teams is how much they can sell with and through them.

We will continue with that firewall-type activity. The reaction from the systems integrators has all been around, okay, let's go do it. They are motivated to grow their revenue. We are motivated to grow ours, so that is something that we will certainly maintain.

Chris Whitmore - Deutsche Bank - Analyst

How large is that business for you currently, the system integrators and outsourcing?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

It's an important segment for us, but the context -- I don't have the number off the top of my head to give you that, but I will give you the context stuff. IBM does a lot of work with all those partners, and if IBM with as big a services businesses as they have can put together a productive working relationship with all those systems integrators, there is no reason why HP should not be able to continue to do that as well.

What we find is it really comes down to having focused resources who are assigned to working with those partners and who have a quota and a responsibility to drive that. So we are going to put a lot of energy on it and it will be my team that does a lot of the work focusing on those people. And they are very important channel partners for us.

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Chris Whitmore - Deutsche Bank - Analyst

To the extent that EDS helps you further penetrate the enterprise, can you give us a sense as to the overall -- the opportunity as you see it in order to cross-sell into those EDS -- that EDS customer base?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

Well, we know today already, based on the outsourcing contracts that HP has won, that when you have an outsourcing relationship with a client you clearly have an opportunity to bring in your products. As long as your products meet their needs and deliver the cost savings and the service levels that they expect, you certainly have an opportunity to do that. We have experienced that with the work that we have done ourselves already. We know that that is the case, so we believe that across the entire portfolio that is an opportunity for us.

At the same time, HP is a multi-vendor provider today. My team supports 10,000 products. We support products from IBM. We support products from EMC. We support products from Sun. We support products from Dell. All the people who are our competitors, we provide support on their products today. It's a good services revenue stream. We will do that and when clients want their applications running on somebody else's technology, we will, of course, do that. Where they don't have a bias and an HP product fits, that is a great opportunity for us.

Chris Whitmore - Deutsche Bank - Analyst

Maybe at this point I will poll the audience to see if there is any questions. In the meantime, I want to get back to one of the presumably large cost opportunities as EDS is getting better utilization out of EDS's labor force. I wanted to maybe better understand what technologies or what processes you can bring to the EDS workforce that wasn't available to them previously. How do you get better labor productivity out of that employee base?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

Well, if you look going forward in the services industry the last five years, all the dialogue has been about offshoring. What jobs are you doing where? How can you use the lowest cost labor? Having a geographic, global delivery capability for services will remain important, but we believe over the next five years the more important thing will be which companies can use technology to automate and deliver its services the best? HP is very well positioned to do that.

EDS is already one of the largest customers of HP software. EDS uses the software that we acquired from Opsware. They use the software that we acquired from Peregrine. They use much of the HP software that is in our IT management and automation portfolios. So you can imagine that they will become one of the most fully deployed users of HP software.

The great thing for our portfolios, for those customers who want to do it themselves, we will sell our software to them and they can automate the delivery of their own IT. For those customers who want to outsource it to HP and have us run it, we will run it and use some of the most sophisticated software tools deployed very well in the environment.

So what EDS will have available to them -- they always had available the software they could just buy and use themselves. But the proximity to the labs and our technology ability to specifically develop technology to automate the delivery services, we think is a huge opportunity for HP.

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Chris Whitmore - Deutsche Bank - Analyst

If you think about that opportunity, it sounds very significant. What kind of timeline do you expect to roll that out and how long before you reach kind of optimization?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

That is something that takes more time, because as was the case -- and we experienced this with HP with our own outsourcing business. As you transition clients, they have got tools -- it takes time to migrate to standard tools. But this I think you should think of as much as a competitive differentiating strategy as much as something that drives immediate value.

Chris Whitmore - Deutsche Bank - Analyst

Any questions from the audience here? Shocking. Maybe moving off of EDS for a minute, why don't we come back to the storage business and the strength you have seen in storage. Storage as an industry seems to have been bucking the trend in terms of resiliency year-to-date. I wanted to understand the strength in your business a little bit better.

How sustainable do you think storage, this storage growth is? To what extent is your strength being driven by product upgrades and refreshing the installed base versus something perhaps maybe more sustainable in terms of market share gains, etc?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

Yes, if you looked at HP's storage business, I will make a comment about our high-end arrays, which we call our XP, our midrange arrays which is the EVA and then the low end, which is the MSA. Our XP business continues to be a good business for HP, but that is not the fastest growing part of the market.

We feel very good about the relationship we have had with Hitachi and the customers we are serving, the product satisfaction there. The really great growth for us has been in our midrange array, which grew 19% last quarter and our low-end the MSA, which grew 19%.

The big differentiator that HP has in those product categories is the ease of installation, the ease of the provisioning, and ease of management associated with it. Customers particularly when you look at some of the shops that don't want to spend a lot of resources on managing storage really care on the ease of deployment. The biggest differentiating factor about both our MSA product and the EVA that customers will feed back to you is those areas.

Our EVA, the midrange array I mentioned that grew 19%, grew at 2.5 times the rate of our biggest competitor last quarter. And so that is more than just a lucky quarter. That was really based on the acceptance and the strength that we have in those products.

We think that over time you are going to see servers and storage gray and merge the line. More and more it's going to be very unclear, are you talking about a storage product? Are you talking about a server product or is it a system?

And this scalable computing we were talking about, some of the cloud service providers, they really buy very storage intensive server units. So we think it's a big advantage for HP to have both servers and storage. The other thing we believe is that over time you see the x86 cost model and business model become the economic model of all computing, whether it's the low end or the more mission critical computing.

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So one of the things you see HP very much doing is taking some of the volume economics advantages we have from our x86 business, which is the number one business in the x86 server space. It has been number one for 12 years. It has the biggest market share.

We are taking that business and using those volume economics to help on our high-end servers and also in our storage business. So we think those are two things that strategically for HP say we have a lot of opportunity to do even more and interesting things with the storage market as well as the server market.

Chris Whitmore - Deutsche Bank - Analyst

You are alluding to significant cost takedowns in the storage business on a go-forward basis. Perhaps you can talk more broadly about your business group in terms of further room for operating margin expansion, excluding the EDS acquisition in terms of what is left in the core business?

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

Yes, well Mark, on our last earnings call that some of you may have heard, made comments about that at a corporate level there is more savings in '09 compared to '08 than we did in '07 and '08. There is still more to do in '09 and my businesses benefit a lot from the corporate reductions in cost, so those show up in a dramatic way in my P&L.

That is one thing that is very important. We believe there is still a lot more we can do around our services business with the delivery costs that we have there, both in terms of managing the third-party labor costs we have and the efficiency of our labor. So there is more that we can do in that space.

In our software business, we have several businesses we are investing in that are still new businesses. They are growth areas for us and as they mature and the revenue gets larger compared to the R&D investments we are making in those new business segments, we have room for margin improvement and profit improvement there. We continue to do reinvestments across our whole portfolio where we will take more mature businesses where we can shift some of the R&D spending.

We did that across our server line to shift spending into our blades business, so you will see us shift spending to fund a new growth area. And while that may in total keep the operating profit flat, it doesn't change expenses. It enables us to invest in new growth areas and grow those areas. So still lots of areas where we believe we have room for improvement across the portfolio.

Chris Whitmore - Deutsche Bank - Analyst

There is one question here.

Unidentified Audience Member

Can you talk briefly in the context of your comments regarding how you think compute and storage will begin to merge and become more tightly integrated? In the context of Cisco thinking the network has a much more important role to play in the data center and in completing IT workloads, what is HP's view of that and strategically how is HP positioning itself should the market move to a more network-central model?

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Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

Yes, we have been investing in something we have described as adaptive infrastructure for the last three or four years. It has been the guts to building out the technologies in the portfolio to be able to help customers manage and transform their data centers to these next-generation data centers. So this is a long-term R&D investment stream for us still with a lot of stuff being spent in the labs.

We believe that in addition to what happens with the network activities, there is the bladed, highly dense environment to blade everything. There is the power and cooling, intellectual property and differentiation that we can drive with it.

There is the management and automation software, which we have invested in with all the acquisitions we have done around our portfolio there. There is the virtualization investments associated with it and then there is the security that has to be built into the fabric of the whole data center environment.

So while there are debates about what is going to happen from a network perspective, what is going to happen from a server perspective, what is going to happen from a storage perspective, we believe it takes that entire portfolio to be able to net together for our customers and that that is going to be the position that HP will move from.

We team tightly with Cisco. We team with other players in the industry. We have some of our own technology with HP ProCurve in terms of our products there. As we see customers evolve from where they currently are, we like the position we have. We like the assets that are in our hand associated with it and we like the relationships that we have from a market perspective.

Chris Whitmore - Deutsche Bank - Analyst

Okay, we have gone over on the allotted time. Thank you very much.

Ann Livermore - Hewlett-Packard - EVP, Technology Solutions Group

Yes, thank you.

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