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HPQ - Q1 2014 Hewlett-Packard Earnings Conference Call

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## OVERVIEW:

HPQ reported 1Q14 total revenue of \$28.2b, non-GAAP operating profit of \$2.4b and diluted non-GAAP net EPS of \$0.90. Expects FY14 GAAP diluted net EPS to be \$2.85-3.00 and non-GAAP diluted net EPS to be \$3.60-3.75. Expects 2Q14 GAAP diluted net EPS to be \$0.62-0.66 and non-GAAP diluted net EPS to be \$0.85-0.89.



## CORPORATE PARTICIPANTS

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**Meg Whitman** *Hewlett-Packard Company - President & CEO*

**Cathie Lesjak** *Hewlett-Packard Company - EVP & CFO*

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## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to the first quarter 2014 Hewlett-Packard earnings conference call. My name is Ellen, and I'll be your conference moderator for today's call. At this time, all participants are in a listen-only mode.

(Operator Instructions)

As a reminder, this conference is being recorded for replay purposes. I would now like to turn the presentation over to your host for today's call, Mr. Rob Binns, Vice President of Investor Relations. Please proceed.

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### Rob Binns - Hewlett-Packard Company - VP IR

Good afternoon. Welcome to our first-quarter 2014 earnings conference call with Meg Whitman, HP Executive Officer, and Cathie Lesjack, HP Chief Financial Officer. Before handing the call over to Meg, let me remind you that this call is being webcast. A replay of the webcast will be made available shortly after the call for approximately one year.

Some information provided during this call may include forward-looking statements that involve risks, uncertainties and assumptions. If the risks or uncertainties ever materialize or the assumptions prove incorrect, the results of HP may differ materially from those expressed or implied by such forward-looking statements. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including but not limited to, any projections of revenue, margins, expenses, earnings, earnings per share, HP's effective tax rate, cash flow, share repurchases, currency exchange rates, or other financial items; any statements of the plans, strategies and objectives of management



for future operations; and any statements concerning the expected development performance market share or competitive performance related to products or services.

A discussion of some of these risks, uncertainties, and assumptions is set forth in more detail HP's SEC report including the most recent form 10-K. HP assumes no obligation and does not intend to update any such forward-looking statements.

The financial information discussed in connection with this call, including any tax related items, reflects estimates based on information available at this time and could differ materially from the amounts ultimately reported in HP's first quarter form 10-Q. Revenue, earnings, operating margin, and similar items at the company level are sometimes expressed on a non-GAAP basis, and have been adjusted to exclude certain items including, amongst other things, amortization of purchased intangible assets, 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 presentation accompanying today's earnings release, both of which are available on the HP Investor's webpage at [www.hp.com](http://www.hp.com). I'll now turn the call over to Meg.

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**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

Thank you, Rob, and thanks to all of you for joining us today. For the first quarter of fiscal 2014 closed, HP is in a stronger position than we have been in quite some time. Since laying out our five-year strategic road map for turning the Company around, we've made significant progress.

We have reignited innovation at HP, and the first quarter was no exception, as we introduced industry-leading technologies across our portfolio. Our focus on rebuilding our balance sheet has resulted in an improvement of our operating Company net cash position by more than \$6 billion since the first quarter of 2013. We strengthened our relationship with customers and channel partners, something I see everyday in my interactions with them.

And our global workforce is fully aligned behind a common vision for the Company, delivering solutions for the new style of IT, and we are seeing acceleration in the industry's movement towards that new style of IT. These changes create tremendous pressure in the marketplace as technologies and business models evolve, customer needs change, and incumbents look to respond. Many of our competitors are now confronting these new realities by making major strategic shifts and exiting significant parts of their business.

At the same time, HP is more than two years into its work to reposition the Company to meet these challenges. We believe this is a competitive advantage. With the steps we've taken, I think we're well-positioned to seize on opportunities that will arise in the marketplace.

We still have a long way to go, but I'm more convinced than ever that we are making the right move to set HP up for the long-term. Rest assured, we are not taking our foot off the pedal.

Over the next few quarters, we will introduce significant new innovations that will build upon our offerings in cloud, security, big data, and converged infrastructure, as well as remarkable new technologies in printing and personal systems. In addition, at our global partner conference next month, we will roll out updates to our partner programs that we expect will further strengthen our channel relationships. We are doing all of this while we continue to optimize our cost base and invest in our infrastructure to help create a more agile and more aggressive HP.

In the first quarter, HP delivered \$0.90 in diluted non-GAAP net earnings per share compared to our financial outlook of \$0.82 to \$0.86 per share. Total revenue for the Company was down 1% for the quarter, but up slightly in constant currency. And we, once again, delivered very strong cash flow, generating \$3 billion in cash flow from operations.

As a result of our focus on driving cash flow, the Company exited the quarter with an operating company net cash position of \$1.7 billion after returning \$843 million to shareholders in the quarter in the form of dividends and share repurchases. We saw further encouraging signs in the quarter that our efforts to turn the Company around are taking hold. There was revenue growth in our personal systems and enterprise group



segments, and at the total company level on a constant currency basis, we achieved revenue growth for the first time since the second quarter of 2011.

As I've said in the past, turnarounds are not linear, and we have a lot of work ahead of us. While I would certainly not declare victory based on these results, they represent real progress. Make no mistake, we are focused on consistently and profitably growing revenue over the long-term.

You've heard me say that revenue growth will ultimately be driven by great products, and in the first quarter we held our annual innovation showcase for our European customers at HP Discover in Barcelona. We used the event to introduce significant new technologies in key areas for the Company.

We introduced our new converged systems portfolio, a family of integrated IT systems using HP server, storage and networking technology that is purpose-built for key workloads such as virtualization, big data and hosted desktops. These new products deliver a total systems experience that dramatically simplifies IT, enabling customers to go from order to operations in as little as 20 days.

We also introduced new solutions in our converged storage portfolio, including StoreOnce backup, StoreAll archive, and StoreServe storage. Collectively, these innovations deliver industry-leading performance and efficiency, making it possible for enterprises to manage their data in the new style of IT.

We announced the next-generation of our flagship private cloud solution, CloudSystem 8. This solution integrates with our open stack architecture, and enables enterprises to build a private cloud and deploy cloud services in a matter of hours, rather than days or weeks. HP was also recently recognized by Forrester Research as the clear leader in private cloud solutions.

We also launched our new hybrid cloud management platform, a self-service portal with key management and security tools that allow IT managers to more efficiently deliver applications and services to their users. Also in the first quarter, our personal systems group introduced two new mobile devices to the market in India, the HP Slate 6 and Slate 7 voice tabs. These tablets demonstrate how we are clearly segmenting markets to target opportunities with cost-effective products that play to our strengths.

Now, let me turn to our business group performance in the quarter. Overall, results in Q1 were driven by the revenue growth I noted earlier, plus solid performance in printing and discipline cost management.

In personal systems, we delivered strong revenue performance. Overall, the PC market contraction is slowing, and we see signs of stabilization, particularly in the commercial segment. Revenue grew 4% over the prior year, our first quarter of growth in seven quarters. Growth was driven by strong performance in commercial, particularly commercial notebooks.

Operating margins for the quarter were 3.3%, up over both the prior year and sequentially. The competitive pricing remains aggressive, which puts pressure on our gross margins. We are being selective in where we play, and as a result, we lost 0.7 points of market share over the prior year in a declining market in the calendar fourth quarter and 0.9 points sequentially.

We believe our approach of being selective about where we play, coupled with good cost discipline, will ensure we remain focused on profitable growth. Our printing business delivered solid results with sustained profitability.

Operating margins for the first quarter were 16.8%, up 0.5 points over the prior year. Printing revenue was down 2% or 1% in constant currency, and while total supplies revenue declined, we did see growth in ink supplies over the prior year.

We also saw a our third successful quarter of hardware unit placement growth, driven by very strong growth in laser units, and Ink in the Office remained strong. The focus on unit placement is an investment that we believe will pay future dividends for supplies.

The overall printing markets saw hardware unit growth for the second successive quarter, driven by strength in laser. For the third successive quarter, HP outperformed the market, getting two points of share over the prior year in total, and in both ink and laser, respectfully.



In enterprise services, a soft revenue quarter pressured margins. As we laid out in our last call, the delayed revenue runoff from FY13 is impacting year-over-year compares for ES. In the first quarter, runoff occurred largely as we expected and resulted in a 1% operating margin, down 30 basis points over the prior year.

We're in the early innings of the transition we outlined in October to drive a more proactive sales approach. In the first quarter, we did see encouraging bookings growth in strategic enterprise services, but there remains further opportunity for us to improve our success in winning new, large customers, and securing add-on revenue from existing accounts. I am confident that we have the right plan and services, and the team has made good progress by executing against their strategy, but this is a big ship to turn, and we need to move faster, particularly on aligning our sales engine and improving our service delivery for higher quality and lower cost.

In the enterprise group, we saw revenue growth of 1% and expect calendar fourth-quarter share gains across all our hardware segments. Results in the first quarter were led by revenue growth in ISS and networking, partially offset by revenue decline in TS. We saw stable performance in storage, where we continue to manage the transition from traditional to converged storage.

Finally, we continued to see revenue declines in business-critical systems. Overall, we are still seeing a very competitive pricing environment in EG; over time, we do expect to improve margins in this business. There is more we can do, and as we look forward we remain focused on better managing our product mix to market segments, cost-saving opportunities, and improving tax rates to drive increased operating margins.

In industry-standard servers, we continued to make progress in stabilizing this business in the first quarter. We had another strong hyperscale quarter, although this contributes to pressured margins.

In addition, we continue to make progress with Moonshot as we load new workloads in the quarter and introduce the first converged system for hosted desktop based on Moonshot technology. Customer interest remains high, and we're working with the number of customers on proof of concept, addressing a variety of different workloads.

In storage, overall revenue was flat. In converged storage, we saw 42% revenue growth over the prior year and 3PAR continues to perform really well, particularly in the midrange segment.

In networking, we grew revenue 4% over the prior year. We saw good performance in switching, which grew revenue 5% over the prior year, comparing very favorably against Cisco's results in the same period.

In technology services, revenue declined 4% over the prior year, but only down 2% in constant currency. We continue to see good adoption of our new portfolio, including proactive care, where orders grew triple digits year-over-year, and flexible capacity services, where we are seeing strong customer demand.

In software, I feel good about the progress we are making. We've simplified the product line while rejuvenating our core portfolio. We are investing in key growth areas and the team is making great strides on areas of operational improvements.

Revenue was down 4% over the prior year, but we grew in key areas of the portfolio, including security, cloud and big data. Weakness in our traditional IT management business, particularly in the US and Asia, was partially offset by strength in security offerings, like ArcSight and Fortify, as well as in our Vertica business. In Autonomy, the technology continues to resonate very well with customers, as they launched Idol 10 and Data Protector 8.1, the industry's first adaptive and self-aware backup and recovery solutions.

In addition, Autonomy announced a major win with China Mobile, selecting Idol to power the search capability of a strategic wireless city platform. This platform allows users to access information on thousands of public services directly from their mobile phones. So overall, I'm very pleased with the progress we've made, but we still have a lot of work to do to drive consistent execution and navigate a rapidly shifting marketplace.



Now, let me turn to our future outlook. The approach we outlined at our security analyst meeting last fall remains our compass to guide us in FY14. We will continue to focus on innovation, cash flow, our restructuring plans, and executing on the areas of improvement in the turnaround, while taking advantage of the realities of the new style of IT.

We are not expecting any significant change in the macro environment. There are definitely some encouraging signs, with improved performance in Western Europe, but headwinds remain in many emerging markets. Against that backdrop, our Q2 outlook for non-GAAP diluted net earnings-per-share will be \$0.85 to \$0.89, and for the full year, the outlook will be \$3.60 to \$3.75.

So now let me turn it over to Cathie for a closer look at our performance in the quarter. Cathie?

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

Thank you, Meg. Overall, Q1 was a good start to FY14, as some of the fundamental improvements we've been driving are beginning to take hold. But as Meg noted, we still are not satisfied with the consistency of our performance or the profitability across some of our businesses, so we remain very focused on improving our go-to-market and cost structures.

Total revenue for the quarter was \$28.2 billion, down 0.7% year-over-year and up 0.3% in constant currency. By region, Americas revenue was \$12.5 billion, down 2% year-over-year or down 1% in constant currency. The decline was primarily due to key account runoff in Enterprise Services in the US, partially offset by a previously announced sale of IP.

EMEA revenue was \$10.4 billion, up 1% year-over-year but down 1% in constant currency. While our immediate outlook remains cautious, we are seeing some signs of stabilization in more mature markets such as Germany and France.

APJ revenue was \$5.2 billion, down 1% year-over-year but up 5% in constant currency. We saw particular strength in India again this quarter and China was flat. Relative to overall market challenges in the region, we are pleased with this performance.

Gross margin for the quarter was 22.8%, up 0.5 points year-over-year and down 0.2 points sequentially.

The year-over-year improvement included some benefit from the IP sale. We continue to experience an aggressive pricing environment across our hardware businesses, which we are offsetting through productivity improvements and greater service delivery efficiencies. Total non-GAAP operating expenses for the quarter were \$4 billion, down 1.8% year-over-year and down 1.4% sequentially.

R&D expense was up over the prior year period, as we continue to invest in innovation in our strategic focus areas such as cloud, and across many of our business segments. SG&A was down over the prior year periods, primarily due to gains from a real estate sale and expense benefits from our restructuring actions.

These benefits were partially offset by higher litigation reserves and investments in systems and tools. As a result, non-GAAP operating profit was \$2.4 billion or 8.5% of revenue, up 0.6 points year over year.

We recorded \$163 million of expense in the other income and expense line, a decrease from the prior year period, driven primarily by lower interest expense on reduced debt balances, partially offset by the unfavorable effects of currency exchange rates. With a 22% tax rate and a weighted average diluted share count of 1.935 billion shares, we delivered first-quarter non-GAAP diluted net earnings per share of \$0.90. First-quarter non-GAAP earnings primarily excludes pretax charges of \$283 million for amortization of intangible assets and \$114 million for restructuring charges.

Turning to the business units. Printing continued to perform well, with solid hardware unit growth for the third consecutive quarter and good profitability, as we continue to push our print strategies forward. Revenue was \$5.8 billion, down 2.2% year-over-year, and unit shipments grew 5%.



Commercial hardware revenue was \$1.3 billion, down 2% year-over-year, while consumer hardware revenue was \$673 million, down just 1% year-over-year. We are seeing contraction in average selling prices across ink and laser hardware, driven by the tough pricing environment and the effective currency exchange rate, but the underlying unit demand is improving. For example, demand for our Ink in the Office products remained strong.

The Office Jet Pro X saw double-digit sequential growth across all regions. And we continued to see double-digit, year-over-year revenue and unit growth in Ink Advantage. In laser, we gained share and are continuing to grow in multi function printers and managed services, and graphics remains a bright spot, with another solid performance in Indigo.

Supplies revenue was down 3% over the prior year period, or down just 1% in constant currency, and made up 65% of printing revenue. Supplies softness was attributable to weakness in toner. Softer toner drove channel inventory levels marginally up above our target range. We're actively managing this, and the net impact to Q1 results was immaterial.

Overall, printing profitability remained solid, with operating profit of \$1 billion dollars and 16.8% of revenue, up 0.5 points year-over-year. The performance in personal systems was better than expected, with revenue of \$8.5 billion, up 3.6% year-over-year, driven by commercial strength. There were signs of improved market conditions, especially in commercial PC, and we are confident about our portfolio and focus.

Although consumer sales declined 3% year-over-year, commercial sales grew 8%. Commercial notebooks grew double digits over the prior year period, and commercial desktops were up as well. Total unit shipments grew 6% year-over-year, with growth in both the commercial and consumer segments. Channel inventory levels are down, and well within acceptable ranges across all categories and regions.

Personal systems operating profit was \$279 million, or 3.3% of revenue, up 0.5 points year-over-year. The results of our continued focus on cost management and the IP sale were partially offset by increased CRAM costs, as we indicated to you last quarter. We remain focused on driving profitable growth in this business.

Enterprise group revenue was \$7 billion, up 0.6% year-over-year and up 1.5% in constant currency. Operating profit in the quarter was \$1 billion dollars or 14.4% of revenue, down one point year-over-year. We believe these results show the progress we are making on sales execution and the competitiveness of our portfolio, as the market shifts toward the new style of IT

However, we still have more work to do to improve profitability in the business. As Bill Veghte discussed at our security analyst meeting, we are focused on specific actions like optimizing our cost structure, while closely aligning the business units in their regions and better segmenting the market.

Our business industry-standard server revenue was \$3.2 billion, up 6% year-over-year, as we saw strong growth in hyperscale again this quarter. Technology services revenue decline has moderated somewhat, with total revenue of \$2.1 billion, down 4% year-over-year or down 2% in constant currency, but profitability expanded and customer satisfaction improved. When you consider the significant headwind of the declining BCS business, the technology services operating profit performance was strong.

In storage and networking, we are driving execution improvements to capture more market opportunity and we are starting to see the results. Networking revenue growth started to accelerate in the first quarter. Revenue was \$630 million in the quarter, up 4% year-over-year.

Storage revenue was flat versus prior year period at \$834 million, as strong growth in converge storage offset declines in traditional storage. Converge storage grew 42% year-over-year, and 3PAR plus EVA plus XP grew 13% faster than the market again this quarter. This metric indicates how well 3PAR is performing in disrupting the marketplace, taking into account the planned transition of our traditional offerings.

Business critical systems continues to be impacted by a declining Unix market. BCS revenue declined 25% year-over-year to \$228 million. We expect to gain 2 points of share in this market.

Enterprise services revenue was \$5.6 billion, down 7.3% year-over-year. The revenue decline was driven by the delay key account runoff, as we indicated to you previously.

The revenue decline, along with the investments we are making in our sales force and increase litigation reserves on legacy accounts, pressured our margins in the quarter. Operating profit was \$57 million or 1% of revenue, down 0.3 points year-over-year. By business, IT outsourcing revenue was \$3.5 billion, down 9% year-over-year, and applications and business services revenue was \$2.1 billion, down 4% year-over-year; both businesses were impacted by key account runoff.

Overall signings were soft in Q1, but small and medium deals grew. Overall, our trailing 12-month book-to-bill is still within acceptable ranges. We've made some progress on improving productivity, but we have to move faster to drive service delivery efficiencies, grow add-on business within existing accounts and capture new logos.

Software revenue declined 3.7% over the prior year period to \$916 million, although we saw continued growth in key areas such as SaaS, Vertica and Security, and gained traction in our innovative big data platform, Haven. License revenue declined 6% year-over-year, due to the continued market transitions to SaaS, as well as some pressure in our IT management business. However, we saw a double-digit growth in Cloud, Vertica, and Autonomy's Idol license revenues.

Support sales declined 2% year-over-year as a result of historical license revenue declines. Professional services sales declined 12% year-over-year, but the gross margin improved, as we continue to prune our portfolio and focus on profitability. SaaS revenue grew 6% over the prior year period, as we see continued momentum.

Operating profit was \$145 million or 15.8% of revenue, down 0.5 points year-over-year. We continue to invest in strategic growth areas of software, and make progress on simplifying and enhancing our systems and processes to increase productivity.

HP financial services revenue was \$870 million, down 9.1% year-over-year. Operating profit was \$101 million or 11.6% of revenue, up 1 point from Q1 fiscal 13. Pressure from volume declines in previous quarters impacted HP financial services revenue; however, new financing volume was up double-digits, driven by strength in the direct customer financing business. The health of our portfolio assets was strong, and return on equity was 18% in the quarter.

Turning to cash flow and capital allocation, we had another strong quarter generating \$3 billion in operating cash flow, up 17% year-over-year, which resulted in \$2.4 billion in free cash flow. We continued our focus on working capital, and got our cash conversion cycle down to 16 days in the first quarter, down seven days from the prior year period. We improved across all metrics, but the largest improvement was in days payable outstanding.

We returned \$565 million to shareholders by repurchasing 20.4 million in shares in the quarter, and paid \$278 million in the form of dividends. For the year, we are still committed to capital distributions, and our plan is to return at least 50% of free cash flow to shareholders in the form of share repurchases and dividends, as we outlined in our security analyst meeting.

During the quarter, we also completed a very successful \$2 billion debt offering, our first term debt issuance in almost two years. We ended the quarter with gross cash of \$16.4 billion and operating Company net cash of \$1.7 billion, a \$6.4 billion improvement over this period last year.

Looking forward to Q2, the market and competitive environment continues to be challenging. While there are signs of recovery in some geographic regions, many areas across the globe are soft. Currency impacts are also affecting the global business environment, and we expect currency to be about a 1 point headwind year-over-year to revenue in Q2.

By business, in printing we will continue to invest in harbor unit placement with a lifetime return on the unit makes economic sense, and we expect to drive continued momentum in key strategies across ink, laser and graphics. For personal systems, while we expect the commercial segment to continue to outpace the consumer segment, we believe the overall market is likely to remain highly competitive.



In enterprise group, we remain focused on more successfully managing the margin profile, and we expect continued traction in networking, converged infrastructure and converged storage. In enterprise services, we expect that the late key account runoff to continue to pressure growth and profitability as we drive forward the transition from reactive to proactive sales.

Finally, in software we expect to see continued traction in key growth areas like big data, while we invest in disruptive technologies like Haven and Security, and manage our portfolio transition to SaaS. As you build your models, please keep in mind there was a net benefit to Q1 results from the few items I mentioned earlier, including the IP and real estate sales, as well as litigation and other expenses.

Adjusting for these items, our Q1 non-GAAP diluted net earnings per share would have been around the midpoint of our previously provided Q1 outlook of \$0.82 to \$0.86. Also, in order to drive further operational improvements, we plan to increase our reinvestment in the business for the full year by around \$0.02 per share, up from the \$0.12 we discussed at our security analyst meeting.

With that context, we expect full-year fiscal 2014 non-GAAP diluted net earnings per share to be in the range of \$3.60 to \$3.75. For FY14 Q2, we expect non-GAAP diluted net earnings per share in the range of \$0.85 to \$0.89. From a GAAP perspective, we expect a full-year GAAP diluted net earnings per share to be in the range of \$2.85 to \$3.00, and GAAP diluted net earnings per share for fiscal Q2 is expected to be in the range of \$0.62 to \$0.66.

For cash flow, based on the actions we're taking to drive for working capital efficiencies, we now expect moderate improvement in our cash conversion cycle from the low 20-day range we estimated previously. We expect this to provide some upside to our original cash flow outlook for the year. With that, I'll open it up for questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

Our first question is from Katie Huberty with Morgan Stanley. Please go ahead.

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**Katie Huberty** - *Morgan Stanley - Analyst*

Thanks. Good afternoon.

Cathie, as you noted, you continue to beat the cash cycle target of 20- to 21-days, so can you just give us a little more detailed view as to what the right realistic near-term cash cycle target is?

And then assuming you still think that the company will drift back to the 20- to 21-day range, are there offsets to that longer-term opportunities in CapEx or cash tax payments or other items such that you can offset an increase in cash cycle longer-term?

Thanks.

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

Thanks, Katie.

So as I mentioned in my prepared remarks, we do expect a moderate improvement in the cash conversion cycle off of the guidance that we previously provided around the low 20s. And we're very pleased with the progress that we've made in Q1.



To drive 16 days cash conversion cycle, which is, just so everyone thinks through this, is actually down a day sequentially, and normal sequential performance is up anywhere from a couple of days to three days. Now, we did have some help in that in the sense that we had some nice favorable revenue linearity, and we also benefited from the IP sale as well as the mix of PCs.

Because if you recall, the PC cash conversion cycle is negative, and so as the TSG business increases its relative mix, it puts some nice downward pressure on the cash conversion cycle. Over the longer-term though, we do expect that that mix from TSG will, in fact, decrease on a relative basis. That will put some upward pressure on the cash conversion cycle.

So we do, as I say, overall expect moderate improvement off of the low 20s that we provided before. We are also very much focused on our capital expenditures and making sure that we are spending everything that we need to spend, but nothing more, and everything that we spend is driving the appropriate returns and we'll continue to be focused on that.

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**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

I would just add one more thing. This is Meg.

The next chapter in improving our cash generation capability is around SKUs and platform rationalization. Because as you think about it, the more SKUs and more platforms you have, the more inventory you have, the more parts you have, and the chances you have the right inventory in the right place at the right time to free. There's more leverage over the long-term, not necessarily in 2014 but there's more leverage in the long-term making sure we have the right product in the right market segment and don't over SKU.

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**Rob Binns** - *Hewlett-Packard Company - VP IR*

Great. Thanks for the question, Katie. Next question, please.

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**Operator**

We have Tony Sacconaghi with Sanford Bernstein. Please go ahead.

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**Toni Sacconaghi** - *Sanford C. Bernstein & Company, Inc. - Analyst*

Yes, thank you. I have a question and a follow-up, please. Cathie, I was hoping that you could provide just a little more detail on the sale of the mobile computing IP that you alluded to, as well as the real estate sale.

I think you also mentioned in your summary remarks that there had been some litigation as well, which was a benefit. Perhaps you could just mentioned the size of each of those, and are they all captured in your corporate investments reporting segment, or are they somewhere else in your segment reporting? And then I have a follow-up, please.

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

Sure. Thanks for the question. So I think what is important to understand is that a number of these items are, what I would consider normal operating transactions for the business. Now, what's different in this quarter and the reason we are calling them out, is that they are larger than they typically are in the quarter. And so we think it's important to provide that kind of color.

What it is that we have got sales of IP that the vast majority of those sales do show up in the corporate investment segment, but there is a small piece that shows up in PSG as well, and then we've got gains on sales of real estate, partially offset by increased litigation expenses, as well as some other smaller items.



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**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

So the litigation expense was not a good thing. It was a negative.

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

That's right. It offset the gains from the sale of IP and real estate.

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**Toni Sacconaghi** - *Sanford C. Bernstein & Company, Inc. - Analyst*

Okay. And where are those occurring? Are those also being captured in the corporate investments line, or are they somewhere else in the reported segments?

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

Right. So the increase in litigation expenses shows up in the corporate other -- corporate investments segment to a large extent, but there's a small piece that is also showing up in the enterprise services group.

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**Toni Sacconaghi** - *Sanford C. Bernstein & Company, Inc. - Analyst*

And the real estate gain?

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

Real estate gain shows up in the corporate investments or corporate other segments, as well.

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**Toni Sacconaghi** - *Sanford C. Bernstein & Company, Inc. - Analyst*

Thank you. If I could just follow up on the services side. You talk about some -- you know, it was largely in line with your expectations for Q1, but you expected the drag to continue. Are you still confident in your full-year outlook of 3.5% to 4.5% operating margin for that business and a 4% to 6% decline in revenues for that business for this year, or were you recalibrating it in light of weak signings and other issues?

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

So we are not recalibrating. We still expect 3.5% to 4.5% from an operating margin perspective and the 4% to 6% decline in revenue.

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**Toni Sacconaghi** - *Sanford C. Bernstein & Company, Inc. - Analyst*

Great.

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**Rob Binns** - *Hewlett-Packard Company - VP IR*

Next question, please.

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**Operator**

Jim Suva with Citi. Please go ahead.

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**Jim Suva** - Citigroup - Analyst

Great. Thank you and congratulations to your team at HP.

You know, you've done a lot of work and it's really showing, which is fabulous. Of course there's always areas for improvement. One area for improvement is, I think, the operating margins of profitability within the services segment. Can you talk a little about that?

Year-over-year you definitely have some trailing off of revenues, which we understand, but given all the restructuring HP has been doing, it's kind of a bit surprising to see the year-over-year operating margins in that segment actually declined year-over-year. We understand the seasonal nature, but the year-over-year decline.

It sounds like you're sticking to your goal. Is it you truly are investing a lot more, and at some point do you foresee turning the corner to positive sales growth in that area, and will that be this year? Help us understand how to bridge the GAAP of the restructuring with the year-over-year operating profit decline. Thank you.

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**Meg Whitman** - Hewlett-Packard Company - President & CEO

So we are at the beginning of, as I said, a multi-year turnaround in our enterprise services business. And this is -- unlike our PC business or even our industry-standard services business, this has nothing to do with the transactional business. These are long-term contracts, and so it takes a little longer to turn the ship around. And we've got work to do on labor, not only the number of delivery centers, our labor pyramid, and we have more work to do in terms of our labor force in Europe, and that is well underway.

We also are doing a lot of investments in our systems and technology. This business really didn't have the visibility and the instrumentation that we needed to run a very labor-intensive business. We've made those investments and they are starting to bear fruit, and I think you will see those bear fruit through the rest of the year. Ultimately, we have to turn the revenue corner here.

We had -- as we've said several couple years now, key account runoff. And we've got to turn the revenue trajectory. And we've restructured our sales organization, we've got seven new practice areas that are designed to meet the needs very specifically of customers, what they want from our services business.

So over the long-term, we're optimistic. This is playing out in 2014, almost exactly, I think, the way Cathie and I thought it would. Do you want to add anything to that?

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**Cathie Lesjak** - Hewlett-Packard Company - EVP & CFO

Maybe I can provide a bit more specifics on the decline year-over-year in the operating margins. What we saw was progress on productivity initiatives, as well as improvement in some of our underperforming accounts on a year-over-year basis. This was offset by the fact that this key account runoff is higher-margin runoff. We continue to have contractual price concessions that we have to make on certain contracts, and then we did increase our investment in some of our OpEx items.

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**Jim Suva** - Citigroup - Analyst

Thank you, and congratulations again to you and your teammates at HP.

**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

Thanks.

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**Rob Binns** - *Hewlett-Packard Company - VP IR*

Thanks a lot, Jim. The next question, please.

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**Operator**

We have Keith Bachman with Bank of Montréal. Please go ahead.

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**Keith Bachman** - *BMO Capital Markets - Analyst*

Hi, guys.

I wanted to ask about enterprise group and PCs. On enterprise group, revenues were up 1%, and ISS actually had another good quarter. The question is, Meg or Cathie, as you look at 2014, is a positive revenue number sustainable for this division? And a corollary question is, on the PC side you mentioned you feel better about corporates.

What is your confidence level in that in terms of sustainability, because it sounds like there is some pull in for XP, but just when you talk about your -- you feel like corporate is better, corporate buying is better. Is that sustainable through the year or does that fall off here as Microsoft goes through its transition? Thank you.

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**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

Let me take a crack at that. It's Meg and then I'll get Cathie to weigh in.

On the enterprise group side, we do think revenue growth is possible through the remainder of the year. We saw good traction in ISS. We still have a BCS drag on the portfolio, and that's going to continue for the foreseeable future.

We're optimistic about storage, particularly 3PAR, and networking got off to a good start. So we've got to continue to execute. We've got to get our sales motion exactly right, and we have to get our innovation into the market and sold in a way that customers can understand and appreciate. So I think feel good about enterprise group.

PSG, you know, I think what most people will be surprised about in this earning's call, is how well PSG did. And I'd do a shout out to Deon Weisler and his team as they continue to execute. Our multi-OS, multi-architecture, multifactor strategy is working well.

Market segmentation and leveraging our strengths in commercial and go to market capability is working well. There was a bit of a tailwind on the migration from XP to Windows, but I wouldn't say that was an overwhelming factor. It was important, but not overwhelming.

I do think there's also some momentum in the long-term in a long overdue PC refresh. What I think commercial customers are understanding from their employees is while employees may want a tablet, they actually also need more traditional compute devices to do their real work in the everyday environment in their company.

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**Keith Bachman** - *BMO Capital Markets - Analyst*

So, Meg, could this be a positive number for the year as you think about PSG?

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**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

Hard to call it. This has been over the last few years a pretty volatile market. You know, my experience over many years in business is you always underestimate on the way down -- or you underestimate on the way down about how bad it's going to be, and then on the way up sometimes it's better than you think it's going to be. But I think it's too early to call. I think we should be relatively cautious here, given the volatile nature of the business.

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

What's really important with respect to the PC business is that we've got to focus on profitable growth. If that means that there is less top line growth, that's okay, because we're focused on profitable growth.

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**Keith Bachman** - *BMO Capital Markets - Analyst*

Thanks, guys.

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**Rob Binns** - *Hewlett-Packard Company - VP IR*

Next question, please.

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**Operator**

We have Mark Moskowitz with J.P. Morgan. Please go ahead.

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**Mark Moskowitz** - *JPMorgan Chase & Co. - Analyst*

Two questions, if I could. With the storage continuing to improve, are you starting to see cross-pollination or cross-selling as a result of that pull through networking in other parts of your business?

And then the second question is more philosophically, Meg. With the continued improvement in the balance sheet in amount of cash flow, is there any change here in terms of organic versus inorganic investments? Could you start to maybe look outside to make some acquisitions, maybe bolt-on acquisitions first before you get a little more courageous?

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**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

Okay. Let me start with storage. Listen, we're making a big push toward converged infrastructure. We rolled out new converged infrastructure offerings, which we call sharks at Discovery in Barcelona. It's a perfect channel product, easy to sell, very specifically focused on certain workloads.

And so we are bullish on storage, and we think that as we embed storage into converged infrastructure, that there is some pull through. At least that's the bet we're making. With regards to acquisitions, we stand by where we were at our industry -- or at our security analyst meeting last October, that we will return at least 50% of our free cash flow to shareholders in terms of repurchase of shares and dividends. But I do think we will be now considering acquisitions.



As this market changes very dramatically, you can see that we may need acquisitions in security, big data, mobility and cloud. We will be very judicious. It'll be returns-based, and I'd say it would be small to medium-size acquisitions. So that's where we're headed, but the capital allocation strategy that we laid out at SAM, exactly the same.

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**Rob Binns** - *Hewlett-Packard Company - VP IR*

Great. Thanks for the question. Next one, please.

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**Operator**

Ben Reitzes with Barclays. Please go ahead.

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**Ben Reitzes** - *Barclays Capital - Analyst*

Can you talk about services just a little more? The 1% operating margin and then you got to get the 3.5% to 4.5% for the year, so how do you get there? It sounds like you kept all your targets. How do we improve as we go throughout each quarter? What are you working on specifically to get there?

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

So, Ben, one of the things to -- if you go back to some of the commentary in the first half of last year, you'll recall that we talked about the delayed key account right off, but you might also recall that we talked about the fact that we were selling more project-based business into those accounts to help them make the transitions that they were focused on, and that increase profitability and revenue but increased profitability in the first half of the year. So we are now working through that.

Because now the account runoff is, in fact, coming through and the project upsale is not happening in those accounts. And so we expected that the first half of the year would always be under more pressure and that we would see more of an uptick -- we'll see an uptick quarter-to-quarter but more of an uptick in the second half versus the first half. We are also making this pivot. We are making investments into our sales force to move from less reactive renewal base to more proactive sales, and that starts to have a bit more of a help in the second half of the year.

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**Ben Reitzes** - *Barclays Capital - Analyst*

Okay. Obviously, more leverage from the restructuring, I assume.

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

Absolutely. We are continuing to restructure, as well. At the total company level, we had another roughly 3700 employees that leave -- that left under the program, and so now we're at running program to date at 28,300.

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**Ben Reitzes** - *Barclays Capital - Analyst*

Okay. Thanks a lot.

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**Rob Binns** - *Hewlett-Packard Company - VP IR*

Thanks, Ben. Next question, please.

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**Operator**

Aaron Rakers with Stifel. Please go ahead.

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**Aaron Rakers** - *Stifel Nicolaus - Analyst*

I want to go back and build on Keith's questions with regards to the enterprise group. Understanding the revenue growth and possibly the expectation that can be sustained throughout this year, how are we thinking about particularly the hardware operating margin trend? It looks like, given your commentary, with technology services operating margin improving, it looks like we've still seen a bit of a deceleration in the traditional hardware operating margins.

Is that really product cycle driven? I think last quarter you also implemented some go to market strategies, so any update there would be helpful. Thank you.

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**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

Let me weigh in and then I'll let Cathie chime in, as well. Listen, we are turning the enterprise group around. You can see it in the revenues and the success in ISS revenues as well as networking and storage. We've still got more work to do on the margin. The margin, Aaron, can improve in two ways.

One is within the product line, because we decide what the deals we're going to go after with what product. We manage our cost structure aggressively. But there's also a mix things going on here as well, because every time we sell storage and networking, that is margin accretive to HP versus our classic ISS business. So those are the two levers we have to pull.

I think we have not demonstrated yet our best efforts in doing this. These things takes a while to turn, but we're on it. We've got the right people on it, and I think you'll see you margin improvement over the course of the year if we can -- if the market holds up and we can continue to execute.

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

I would add maybe a couple more points. First, it's not just storage and networking, although that's a big piece of the mix. It's also our new products.

Our new products have better margins as well, and then just as you think about the profitability of EG for the year and you go back to what we said at the security analyst meeting where we said that EG's contribution to the year-over-year improvement in EPS at the company level would be anywhere from a penny dilutive to a couple cents accretive, and this is before the basically \$0.12 at that time that we were investing back into the business, and now we're adding an additional \$0.02. And so we still believe that that's what the result will be in EG.

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**Aaron Rakers** - *Stifel Nicolaus - Analyst*

Thank you.

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**Rob Binns** - *Hewlett-Packard Company - VP IR*

Next up, please.

**Operator**

Brian Alexander with Raymond James. Please go ahead.

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**Brian Alexander** - *Raymond James & Associates - Analyst*

Thanks.

If I could go back to the cash flow, Cathie, you mentioned that the cash conversion cycle should be moderately better than you expected. I think everyday improvement is a few hundred million dollars a quarter in cash flow, so is your operating cash flow target for the year rising by \$1 billion to \$2 billion, or are there offsets to that?

I didn't hear a specific number relative to your original goal of 9% to 9.5%. I was just hoping you could be a little bit more specific.

Thanks.

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

So I didn't provide a very specific number, because we don't typically update our cash flow guidance on a quarterly basis. But you should read through that if the cash conversion cycle is moderately better than the low 20s, we're not seeing the same level of degradation in the cash conversion cycle as we had originally expected that that would give us a bit of an uplift to the cash flow for the year.

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**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

And I think if I heard it right, Brian, you said that the cash flow guidance had been 9% to 9.5%. It's actually 6% to 6.5% that's free cash flow.

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

Okay.

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**Brian Alexander** - *Raymond James & Associates - Analyst*

Exactly. Okay. Thanks for that clarification.

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

But there should be a bit of upside to both of them.

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**Brian Alexander** - *Raymond James & Associates - Analyst*

Great.

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**Rob Binns** - *Hewlett-Packard Company - VP IR*

Thanks, Brian. Next question, please.

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**Operator**

Steve Milunovich with UBS. Please go ahead.

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**Steve Milunovich** - UBS - Analyst

Thank you.

Obviously, your execution is much better. But Meg, you talked about better reposition of the company kind of relative to your competitors. I was just going to challenge you a little bit on that. IBM, obviously, is getting in on the servers.

You kind of alluded to that, but that's because they see it is a very low margin business. Your software exposure is still quit low relative to your competitors. You've actually become somewhat more dependent on printing over the last 12 to 18 months. So I know I am picking on the negatives, but can you talk about what you mean by improved repositioning, particularly from a competitive standpoint?

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**Meg Whitman** - Hewlett-Packard Company - President & CEO

Sure.

So two and half years ago we embarked on some pretty significant changes to this company around the cost structure, around our pivot to the new style of IP, around investment in innovation. We totally understood what was happening in this market two years ago, and we began to take actions. I think what you see is our competitors now having to take some of those same actions around cost reduction. You're starting to see some weakness in their results which we saw two and half years ago.

My point is that I think we've been hard at work on doing a lot of things that are going to position us as this industry continues to go through some very challenging changes. The pace of change and the magnitude of change here is as great as I've seen in my career. I think we're reasonably well positioned take advantage of those changes.

We have businesses that are declining businesses. We understand where they are, we understand what we need to do with them. We've got businesses that are holding in terms of revenue and then we've got growth businesses.

And we have pivoted investment. We've pivoted people. We've pivoted go to market to those growth areas to the company.

And by the way, it started two years ago. I would say we have a running start. We never underestimate the competition, but I think because we were in such a tough situation two and a half years ago, we got a head start.

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**Steve Milunovich** - UBS - Analyst

That's fair.

And what are you hearing from your customers? Are they in fact making architectural decisions that are deferring some of their purchases right now or not?

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**Meg Whitman** - Hewlett-Packard Company - President & CEO

So I'm hearing two things for our customers. One is tremendous increase in confidence in HP. We look like the paragon of stability right now, which is very different than it was two years ago. They have a lot of confidence in where we're headed from a product road map perspective.

They are making decisions -- architectural decisions. We don't see them holding off on that. There's movement around cloud. There's movement around which -- are they going to make a bet on HP's hybrid cloud? So there's a battle going on for architectural control in the enterprise. We feel good about where you are in that.

It's early stages. There's still a lot of proof of concept. There's still a lot of trying to decide what workloads people want to move to the cloud, what kind of cloud they want to move those workloads to, but I would say particularly within cloud and then big data, we've got a very compelling offering. This hybrid cloud offering that we crafted well over a year and a half go, it's the right answer.

I can tell you every single day, customer say, this is exactly what I want. And then in big data, the response to Haven is tremendous because everyone's looking for a big data analytics platform that is based on Hadoop, that can combine structured data plus unstructured data with enterprise grade security, with the ability for them to write apps, us to write apps and the ecosystem to write apps.

And the response to that is another really good thing in the marketplace. So it's a battle. It's a knife fight every single day out there, but we feel like we've got the right ammunition.

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**Steve Milunovich** - UBS - Analyst

Thank you.

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**Rob Binns** - Hewlett-Packard Company - VP IR

Thanks, Steve. Next up, please.

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**Operator**

Shannon Cross with Cross Research. Please go ahead.

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**Shannon Cross** - Cross Research - Analyst

Thank you very much. Can you talk a bit about what you're seeing in the toner business? Specifically, you talked about year-over-year declines in terms of revenue this quarter, how you think that plays out through the year, and you noted that the channel inventory's up a little bit. Just any color you can give. And then I have a follow-up.

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**Meg Whitman** - Hewlett-Packard Company - President & CEO

Sure. Thanks, Shannon.

What we're seeing on the toner side is definitely softness, and just to be clear on the ink side, we saw growth in ink supplies, and it was really toner that took supplies down the 2.5% that we saw, and that was also -- currency also contributed to that.

But I would say the toner softness was due to two big things. One is, we were seeing incrementally much more aggressive price competition from some of the Japanese competitors who, of course, have the benefit of the weaker yen. And then we are starting to see increasing competition from close and remanufacturers, as well.



**Shannon Cross** - *Cross Research - Analyst*

Okay, great. And then can you --

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**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

I'm sorry. I was just going to say is we've got to continue to place laser units with positive lifetime value. I think what we said the third consecutive quarter of incremental placement in laser our portfolio of multi-function color printers is actually now hitting its real stride. We just introduced many of them at the end of last year or even the beginning of this year.

We are gaining share in the category that HP had been underrepresented. If we were underrepresented in that market share, it means we didn't have the toner trailing that market share. Now we have a product, and so the units we are placing today to pay dividends next year and the year after. So I think you should feel good about the share gains we are making.

Lastly is the managed print services. This is where the benefit of managed print services is we get 100% of the after market. And so that's an important thing, as well. And what? Four or five years ago we didn't really get another business there, and now that's a successful business for us and we're growing it.

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

Yes and the PCB in that business this quarter was up strong double-digits. So continuing to make good progress in management services.

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**Shannon Cross** - *Cross Research - Analyst*

Okay, great. And then if you can talk a little bit about the server business. Specifically, I'm curious to what you are seeing in terms of the IBM sales, any opportunity to gain share there, and how you're looking at targeting some of that business?

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**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

So as everyone on the call knows, Lenovo announced they're buying IBM's X86 server business from top to bottom. And that good news is that it does create an opportunity for us, because what I have learned about this business is instability and questions about the future make it very difficult.

Because people want to bet on a road map, and they're worried that as a change of ownership occurs, is the road the same, is the investment the same? Is the better market going to be the same? Is the service going to be the same?

So I think we have a near-term opportunity here to gain share in our enterprise services -- or in our server business. So we're all over it. We're all over it with our channel partners. I think there's a good near-term opportunity. In the long-term, obviously, Lenovo is going to be a powerful competitor and we aim to be well set up by the time the deal is done to compete really aggressively.

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**Rob Binns** - *Hewlett-Packard Company - VP IR*

Great. Thanks a lot, Shannon.

Next question, please. We have time for one or two more.

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**Operator**

Bill Shope from Goldman Sachs. Please go ahead.

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**Bill Shope** - *Goldman Sachs - Analyst*

Thanks.

Can you give us a bit more color on the traction you're seeing with the new portfolio offerings for the technology services business? Over time, how should we think about when an increased attach rate here can fully counter some of the hardware install base erosion you mentioned, given that is somewhat of a moving target?

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**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

There's a couple things going on here. First of all, part of the decrease is that we have taken a grow only profitable revenue in technology services consulting. This was a business a couple years ago that was actually not very profitable or maybe even losing money, so part of the decline is a conscious decision to be in a consulting business only that makes money. But you're right.

There was a very high attach rate to BCS and as BCS declines, you're going to see some natural degradation. I think the TS team deserves a huge amount of credit for product innovation that has mitigated that decline. Proactive data center care is the bookings, Cathie, right, are in triple digits. I mean, this is a very well-received product in the marketplace.

And then flexible capacity services, which really capitalizes on the trend of infrastructure as a service, so what flexible capacity services is is we can roll in a unit of computer into a customer's data center. They control it, it's on the premise, and yet they can pay for it on a, if you will, as a service basis. There's a minimum that they have to consume. There's obviously a maximum that that unit of compute can deliver, but they have ability to flex up and down.

It turns out that actually works for us because we of HP financial services, so we don't have the balance sheet problem that you might imagine on an as a service infrastructure project. So we're excited about both of those. There's a big pipeline.

This product, by the way, flexible capacities service was pioneered in Europe. We've got a big pipeline there, and proactive data center care off to a really, really strong start. So shout out to the team, because they have really -- they saw what was happening, and they responded with product, which is what HP has to do. We have to keep innovating because as some businesses start to fall away, we have to new businesses that can take their place with higher margins.

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**Cathie Lesjak** - *Hewlett-Packard Company - EVP & CFO*

I think it's also important in the TS business to understand that roughly half of the decline is as a result of currency, and if you actually had modeled what the decline in hardware over the last year would do to support, it would be materially more than what we are seeing, and that's the result of all of these new product innovations that Meg was talking about.

Specifically in terms of penetration rates, we are seeing growth in both storage and networking penetration rates. That is going to help offset some of the pressure that we're seeing from BCS declines.

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**Rob Binns** - *Hewlett-Packard Company - VP IR*

Thanks for the question, Bill. Time for one last one.

**Operator**

Next we have Maynard Um with Wells Fargo. Please go ahead.

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**Maynard Um** - *Wells Fargo Securities, LLC - Analyst*

Thanks. Meg, so you've been in the CEO position for three and a half years. Presumably you have a better feel for areas that are non course. I'm wondering if we might see more divestitures coming this year.

I was also hoping if you could just elaborate on the account runoffs and in particular the Navy contract, which was extended from June to September. So I'm just wondering what the dynamics there are, and if that helps this fiscal year in terms of the revenues and the profits for the services segment.

Thanks.

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**Meg Whitman** - *Hewlett-Packard Company - President & CEO*

Sure.

Actually, I've been here two and a half years. Sometimes it feels like three and half, but I've been here two and a half. Obviously, I have a much better feel of the product portfolio and the capabilities of the organization. Now we're in the position of really looking at the portfolio within the portfolio within the portfolio.

Right now I don't see a major move of the big four businesses, but this is a vast portfolio and there are product lines and smaller businesses within these big operating divisions that could be candidates for divestiture. We haven't made any decisions, but we are now getting to the natural course of, okay, do we have the optimized portfolio? With regard to the Navy contract, this was actually not really a key account runoff, because the Navy contract was rebid and we won for 10 years. So we are excited about the contract.

It was a lower margin contract, as you might imagine, but we are in a very good position with the Navy, but there was profit pressure from a decrease profitability as we rebid that Navy contract. But it's not a runoff. It's just another 10 years at slightly lower margins.

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**Rob Binns** - *Hewlett-Packard Company - VP IR*

Super. Thanks very much. That concludes the questions, and with that we'll wrap up the call. Thank you, everybody, for participating. We'll talk soon. Thanks very much.

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**Operator**

Ladies and gentlemen, this concludes our call for today. Thank you.

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