

FINAL TRANSCRIPT

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HPQ - Hewlett-Packard at RBC Capital Markets North American Technology, Media & Communications Conference

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PRESENTATION

Amit Daryanani - *RBC Capital Markets - Analyst*

Hello. Good morning, everyone. For those of you who don't know me, my name is Amit Daryanani. I cover the electronic supply chain and enterprise systems group at RBC. Very excited to have Tony Prophet, SVP of Worldwide Supply Chain Operations of HP Personal Systems Group to help kick off the conference today. Tony is essentially in charge of overseeing PSG, our Personal Systems Group's worldwide supply chain and procurement of all (technical difficulty). We will aim to keep the keynote fairly interactive. So we will have Tony start off with a 20, 25 minute presentation and we will take it to Q&A from there. So with that I'll turn it over to Tony.

Tony Prophet - *Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG*

Thank you. Good morning. And as Amit highlighted, I lead the Supply Chain Operations for HP for the PC part of the business. So most of my comments, specific comments, will be focused on the PC part of the business.

I also lead the purchasing for strategic components across HP. So think about memory, chipsets, microprocessors, hard disk drives -- those sorts of commodities. And so I'll extend my comments to talk about some of the things HP is doing to continue to improve the supply chain across the business.

I would like to start with just a Safe Harbor statement here. Some of the comments I will offer -- I'll be joined on the stage. Okay, thank you. I'll be joined on the stage later by Cliff Wagner, who is the Director of Investor Relations that leads [this] part of Investor Relations for HP. So some of the comments we offer may be forward-looking that involve risks. And to understand the specific risks, look to our 10-Q.

So to start with an overview of the HP supply chain. World's largest scale of the supply-chain. If you look at all of the purchases of and value-added purchase of components, logistics, transportation warehousing, services associated with the supply chain, it exceeds \$60 billion. So we believe it's the world's largest IT supply chain. It is massively scaled and we will share with you some of the statistics of the scale of the components that we buy and the transportation that we use, as well as the number of nodes involved in our network, which we see as an opportunity going forward.

The business has, in our view, an industry-leading or a leading product breadth in the portfolio of things that we do and products that we offer and solutions to customers and countries in which we offer those solutions. And that is both an opportunity and an issue. And so as I walk through the story on a pan HP basis, you will see some of the complexity, and we see that as an opportunity to continue to reduce costs and increase our competitiveness going forward.

So this is a pictogram of the product breadth. I think many of you are familiar with HP and the breadth of things that we do from the client side with notebooks and desktops and workstations, all the way through networking with ProCurve and now



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3Com. So extensive product breadth in client, in server, in storage, in networking, in imaging and printing. So, extensive hardware breadth. And the discussion today is principally focused on the hardware supply chain.

Here's some of the metrics that give you a sense of the scale, so producing a PC or shipping a PC, about two PCs every second, likewise about two printers every second, likewise a server about every 15 seconds. So very, very high velocity. Very, very high scale.

I'm going to talk now specifically about the PC business, the history of the PC business and some of the products we've made over the last four years. And really even looking a little bit further back, the progress that -- some of it really started post-merger with the HP Compaq merger.

So this is the IDC viewer share and the chart speaks for itself. We've had a solid run in terms of gaining share in late '06. Really reached a point where we became number one and have had established some headroom and feel good about the share of position that we've established.

From a supply-chain basis, I think it's important to note that throughout this period, there have been many windows of significant component challenges and shortage. And I think, again, as you follow the industry, you've heard about many of them and the challenges that folks have faced getting components. For example, in late '06 when we made that transition, there was a significant -- challenges in getting memory bits. And you've got memory bits, you gain share -- was the circumstance that we saw back then.

And throughout there's been challenges in each of the windows, and I think you've heard of some of them of late. And we believe that our scale and the tactics that we use in our supply-chain position us to benefit in times of component shortage.

This is a look at the supply chain costs for PCs only. So I want to be clear when I say supply chain costs, it's the cost of transformation, transportation, duties, etc. So it's not the cost of memory and microprocessors. So think about this order of magnitude \$50 or less. That's what it costs to make and transform a PC.

And this shows the history of driving that cost down in an absolute sense. These are nominal dollars. And driving it down -- the line shows the history of driving it down as a percentage of revenue even in the face of, as you've seen in the industry, significant pressure on the ASP, average selling price. So we've had good success in managing these costs and driving them down in an absolute sense, driving them down as a percentage of revenue.

I'm going to share with you some of the tactics that have allowed us to drive this sort of performance, but again to put this in context now, the cost of manufacturing and transformation in a typical PC is now less than the cost of the memory in the PC.

So this is the history of where we started from, where we started this transformation. And I think this is a part of the HP story that's little known outside the Company, so immediately post-merger, this was the supply chain footprint -- again, this is the PC part of the Company.

About 70 sites worldwide. This is a legacy of what was inherited from HP and Compaq. Many company-owned, many in relatively high cost locations. And additionally, many of them focused on building desktops. And this was really kind of at the eve of the secular shift where no books started taking off and desktop demand was growing relatively slower than notebooks. Still growing, but growing relatively slower than notebooks.

So, and again, this complexity is really just the tip of the iceberg. So you see these 70 nodes -- more or less 70 nodes -- and each one had a significant amount of complexity in terms of inbound hub, outbound hub, the IT connections and the overhead it took to manage a network this complex. So clearly for the Company to survive and prosper in the PC space, we had to get after this and this had to be transformed.



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This is the result. So this is in 2009, more or less the way that it looks today. So the approximately 70 nodes transformed to less than 30 nodes. You can see that more than concentrated in more competitive locations, cost locations. You can't see that few of them are Company-owned. And this is a blend of factories that HP owns and partner factories. But few of them are Company-owned.

But the transformation has not been about solely reducing the number of nodes. It's been about concentration, scale, driving the right factory costs and positioning for growth. So while we have substantially reduced the number of nodes, we have significantly expanded our capacity in key markets, positioning us for growth. Significantly upgraded capacity that we access in Brazil. Likewise in India, an upgraded HP-owned factory there. But first, we believe the first multinational to be producing PCs in Russia. That plant was launched this year.

Expanded our capacity at our factory in Shanghai China. And then we believe the first major PC factory in western China, which we see as an important growth market for China and obviously in the global context. And we'll talk to you a little bit more about that and what we're doing in western China.

So, HP has been crafting a strategy of how we expand our PC, both notebook, desktop, as well as monitor manufacturing from what historically has been obviously a global network, as you saw before, but in China it was largely focused on the coastal regions.

So, about two years ago, more or less, we threw in a valuation. We decided that it would be prudent to move some of the manufacturing inland for a couple of reasons -- one is in terms of labor availability, factor costs, as well as proximity to the market. And if you look at where the investment in infrastructure, industrialization and focus for China is, there's an important emphasis in western China.

And so, we saw an opportunity to grow in western China. There wasn't a significant manufacturing footprint for PCs there. Through a fairly lengthy process, we selected Chongqing. If you look at Chongqing, it's fairly far -- Central West. And in that circle, you go out about 1200 kilometers, there's about 300 million people, more or less, about 300 million people. So standing alone, that would be the world's fourth-largest country. So, we think we have an early advantage here in being in the West and offset some of the challenges that you might see for those -- the operations in the East.

So, the factory that we are -- the factory complex that we are developing in western China has two purposes. The first purpose is to build in China for China. And the factory was commissioned for that purpose this year, January 26 to build desktop, notebook and monitors in China for China, principally for Western China.

The second purpose, and this is -- we hope to commission this later this year, is for export of notebooks from China. And so in the picture, you can see the first trial run, see if you were in Central China, how do you export notebooks from Central China?

You have two principal avenues. One is -- we're going to work on is a rail sea link, to move by rail on a relatively expedited basis, block freight train, relatively high speed by rail to the port in Shenzhen and then by sea to the various harbors of Long Beach and Rotterdam, etc.

And the second link is an air link. And you can see in the lower photo, the airfreight -- the air terminals that are being built, so new airfreight terminals coming up that didn't exist before, an expanded runway runway, long enough for 747 freighter [hot day] that positions us to export by air or by sea from Central China. And you can see on the upper right hand, the ceremony celebrating this first block train that was our first export on a trial basis of PCs from Central China.

So we think that's an important balance from us. It allows us to balance our footprint, our global footprint, because we're not just in China. But it allows us to balance our global footprint in China with the West and the East.



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So that's the PC business and some of the things that we've been working on to be in markets that are growing, to balance our factor costs, to be close to our customers while reducing the footprint and increasing our economies of scale.

Now, that's within the business vertically. If you look horizontally across the business, over that period of time where much of this work has been done in the PC business, in the printing business, in the enterprise hardware business, less work has been done; less progress has been made across the business. And that's really the challenge that we are embarking upon now, to try to optimize the business across the business, across the three principal hardware businesses.

So when you look across the business, our view is that the business is massively scaled, but it's unnecessarily complex. And I'm going to show you briefly some of the dimensions of that complexity. And as again, I highlighted, we made recent progress -- less of it across the whole Company. And we see an important opportunity to continue to take costs out and increase our competitiveness as we look across the Company rather than vertically within each of the businesses.

So our aspiration is -- our aspiration is to build the industry's best supply chain. And in the words of Mark, Mark would say we want to build a 10 out of 10. That's our aspiration. And we're going to talk to you briefly -- conceptually, how are we going to do that? Where do we see the opportunities? What might we change?

So to just kind of replay the story I just shared with you earlier on the PC supply chain, and you can see the blue dots here relatively concentrated and proud of what we accomplished, taking the 70, approximately 70, down to approximately less than 30. But then you layer on it the enterprise hardware business, the green dot, and it starts to look less consolidated, right?

And then you layer onto that the imaging and printing nodes and it looks even less consolidated. And then finally you layer on the distribution points and it looks highly fragmented. So more than 450 nodes in the totality of HP of our supply-chain networks, ship-from points, manufacturing points, warehouses etc. So significant.

And where is the opportunity? Well you think for example -- if you looked in just Southern California, for example, we have three warehouses. So if material is coming from China on a ship, and comes through Long Beach for the printing business, it might go to one warehouse -- it does go to one warehouse. And for the PC business it goes to a different warehouse. And if it was notebook coming by ship, it goes to yet a different warehouse.

And some of these warehouses are within 20 or 30 miles of each other. They're not always fully utilized. And they will ship outbound on a truck often to the same customers. Obviously the volume businesses -- the imaging and printing business, the PC business -- share many of the same customers, customers like Best Buy and Wal-Mart and Ingram and Synnex and Tech Data. So the trucks might be destined for the same distribution center, but they're leaving different outbound points, therefore they may be full; they may not be. You may get full truckload rates. You may get less than truckload rates.

So the opportunity we see is obvious is to work to consolidate those points, those nodes, and then to consolidate the transportation to drive further economies in terms of real estate and the overhead to operate these nodes and increase full utilization of full containers and full trucks and full airplanes.

Okay. So, said succinctly, our intent is to converge on a smaller set of nodes for the business; to reduce the number of logistics partners that we have; and to consolidate our freight volumes where we are using less than truckload, less than container-load to get better economics on the freight regardless of what the cost of fuel does. So a relative competitive advantage.

So shifting from the physical network to the component side of this, we are the industry's largest buyer of most key components that you would see in a PC or a server. We would call them industry-standard components. So the metrics are here. They're approximate metrics of what we buy in each of these components.

I'll give you another example of where the scale -- how that scale extends into other commodities. We're one of -- typically one of the largest or the largest buyer of outbound airfreight out of Shanghai airport. And typical day could be seeing the equivalent



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of a fully loaded 747-400 freighter less than every 10 hours full of HP product. Those are principally notebooks. So, that's a lot of scale on that lane in terms of volume and in terms of -- and should be in terms of buying power. So significant scale in many commodities, not just hardware. Also in transportation.

So, our strategy has been and continues to be to take the scale from the left-hand side, and printers included, the PC scale, and to drive that scale, to drive those industry-standard components from left to right, and we've made great progress.

Obviously in industry-standard servers, we're an early leader there and a leader in many of the segments, particularly in the Blade space. And if you look at these businesses, the business-critical server, we've driven up to close to 70% industry-standard components. The ProCurve business driven up to close to 70% industry-standard components. Our industry-standard server business is about 80% industry-standard components. So working to continue to drive industry-standard components from the left to the right, standardize the components, and to continue to innovate on top of that with software and solutions on top of these high-volume, low-cost standardized solutions driven from the left.

So again, broad strategy in the space of the materials that we buy is to centralize the common commodity. So some of the commodities, the procurement of those commodities have historically been centralized, like memory. Other commodities that even though they're industry standards like power have not. Our strategy going forward is to bring those commodities together to further standardize them and to get better purchasing economies of scale.

To continue to improve our purchasing discipline, which is pretty tight where its centralized, less tight where it isn't. And as I said before, can [send use of] standards across the business.

The final dimension of the transformation, so we talked about the physical network, how we are transforming it, both the points of distribution and the transportation. We talked about the procurement side of it, the parts that we buy.

The final dimension are the processes and IT applications that we use. This is -- so we've gone through over the last year, an extensive process of evaluating -- extensive activity of evaluating how many processes do we use, how many distinct processes do we use? And there's many different ways of measuring it.

I think the relative measure is more important than the absolute measure, but the bottom line is we have far too many processes to do the same thing within -- even just when in PSG is the Personal Systems Group, IPG is Imaging and Printing. ESN is the enterprise hardware business. So far too many even within a vertical business, much less across the businesses, right?

How does this happen? It happens by processes are often specialized by product type, so you would have a different process for notebook, or for desktop, or for consumer, or for commercial, or for NEA than you would have for APJ. You take all those permutations, you end up with a lot of different ways to do the same thing. Our intent is to have many fewer ways and common ways to do similar things.

And so overall, by our count, we have thousands of processes -- more than 1,000 processes, hundreds of IT applications. And our intent is to drive these much more to standards, to move to common ways of doing the same thing, not just within each business but across the businesses, move to common IT applications that embody those processes and that allows us to create -- take complexity out from an overhead activity and to be -- look simpler to both our supply partners because it allows them to reduce costs because we look simpler to them, and look simpler and have a more common interface to our customers.

The architecture we are driving towards is the multiyear journey. We see it as this sort of architecture for our processes and the IT applications that embody those processes. A set of volume-based processes for our volume-based businesses; think about that as PCs and printers instead of value-based processes and potentially Industry Standard Servers. Think about value-based processes for the highly configured things. Think about racks and the Indigo and Scitex printers. And then the set of unique processes for services and unique processes for software.



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So, broadly, these are the opportunities that we see. Sharing more nodes across the business as well as the transportation lanes, less than 25% more or less of these activities are shared across HP today. Sharing more of the critical applications and based on common process standards, and driving further the common -- first of all, driving more standards, then driving further integrated centralized purchasing of those standard components. So, that is the overview of the journey. Again on those three dimensions, network, purchasing, process and IT application.

QUESTIONS AND ANSWERS

Amit Daryanani - *RBC Capital Markets - Analyst*

Thanks a lot. Maybe just to start off the whole process here, one of your competitors have talked about component shortages ending up impeding their demand for the last couple of quarters. Can you just talk about what you're seeing in those component shortages, how HP [is moving that], given the size to leverage the procurement data?

Tony Prophet - *Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG*

Yes, okay. Again, looking backwards, in the early parts of that journey, if you look to how HP bought commodities, take memory, for example, a significant fraction of our purchases were on the spot market. And we were not making long-term commitments to buy volume from the major suppliers that were thinking about how do I invest in a fab for next year and the year beyond and the year beyond. We were largely buying -- principally buying on the spot market.

So we shifted our strategy over the last two or three years to much less activity on the spot, much more activity on a long-term commitment basis, where we know we can depend on those critical suppliers for their capacity and they can depend on us for our demand. That has been our strategy. We think it has served us well.

You don't always get the very, very best price if the spot market collapses. And you don't suffer the pain when the spot market explodes. And so that stability has served us well. And we think now as the industry's largest purchaser of memory, we believe that we are for DRAM, imagine the implications for the industry if we were buying most of our material on the spot market. It might be more volatile.

Amit Daryanani - *RBC Capital Markets - Analyst*

All right. So I guess the other part of the whole thing sort of becomes -- there's a sense and expectation we'll have a good PC upgrade cycle towards the end of the year, given how aged the PCs at least in the corporate environment. To the extent you get that expectation we have 20% to 22% PC unit growth in 2010.

On the same token, you talked a lot of the component (inaudible) that drives the memory, no one seems to be adding capacity fast enough. Could you end up in a scenario in the back half where that is demand but enough components to go around?

Tony Prophet - *Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG*

Well let me talk first about the refresh cycle, specifically to the point that you made. We again, backward looking, talking about Q2, we saw solid commercial client growth, 18%, 19% commercial client growth. We saw strong growth -- very strong growth, greater than 40% in the workstation business, which is typically think about that as an enterprise-like product. So maybe the beginnings of that, the beginnings of the refresh cycle. Our guidance is unchanged and is not based on any acceleration beyond kind of the typical seasonal trends.

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To the second part of your question on the -- we do expect some continued tightness, just based on where we executed Q2. And with regard to the guidance we offered and the comments that were offered in the conference call was that we did expect some continued tightness in the back half. We feel pretty well positioned, both with our own inventories and the relationships that we have, no different than we did as we exited Q2.

Amit Daryanani - RBC Capital Markets - Analyst

Got it. But I guess as you get to the back half, do you think the component guys are going to keep adding capacity, but do you think component shortages actually being an impediment to demand in the back half?

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

I can't speak for the component guys. There's many, many factors that affect their output, including the yield even if you don't add capacity. So those are complex -- that's complex calculus. So I can't speak for them in terms of their capacity adds. I think we stand by our view that there could be modest tightness. We think we're pretty well positioned.

Amit Daryanani - RBC Capital Markets - Analyst

You showed some really interesting charts I think in terms of the nodes that the PC -- PSG group has and when you overlay that with all the different ones. You've done a great job of consolidating the PSG nodes over the last several years. What's the timeline to potentially do that pan HP, and what the ramifications of that could be on cost savings over time for you guys?

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

Yes. Our view is -- and our roadmap is to work to consolidate those nodes over the course of the next -- by the end of 2012. That's our objective. So, that's the timeline.

And again, that's all the transformation that we've undertaken. I'm not going to offer you specific guidance on the opportunity, but I think you can see, when consolidating within PSG, the amount of cost we took out of the supply chain, right? And again, that's not the component cost. Because the component costs go where they go. We don't control that. We just try to get a better cost than the industry for those components. But for the transformation costs and our costs, we see opportunity to take significant cost out.

Amit Daryanani - RBC Capital Markets - Analyst

Would the consolidation be the same magnitude you saw on the PSG side? At least in terms of number of nodes getting cut by more than half?

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

I wouldn't offer that. We see it as material and I wouldn't offer any specifics.

Amit Daryanani - RBC Capital Markets - Analyst

So, if I go back to kind of the last analyst day, you talked about some of the key but critical things. One of them is actually consolidating the nodes. You talked about centralizing IT, sharing IT infrastructure and also centralizing procurement. How is the procurement and centralizing IT infrastructure going? Is there a timeline to that process?

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Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

Yes, they're all the same. It's all part of a single transformation. These are the three arms of the transformation. They're all on the same timeline. And so they're all progressing.

Actually, the procurement thing is because you're not necessarily changing something in the physical world or writing code. Those things might happen a little bit faster than some of the network and IT things, where there's more complexities involved.

Amit Daryanani - RBC Capital Markets - Analyst

Got it. Let's just go back to the component side for a second again. How do you see pricing from a component perspective playing out for you guys? It's obviously been a headwind for all you guys in the last couple of quarters. Does that start to ease up in the back half or does that continue to be a headwind from a pricing margin perspective?

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

Yes, well backward looking, I think we've all seen, if you are following closely, kind of the roller coaster of pricing for, again, backward looking for memory in the past 12 to 14 months, memory prices have more than doubled, more than doubled. So you're asking about component pricing. That's the kind of headwind you've seen.

I think you've also observed the margins of our business have been resilient to those sorts of headwinds. So, that's -- our intent always is to get a fair price, and get the industry's best price. And we are -- we can't really control where those prices go. We expect a little bit of pressure and we've offered that guidance before -- a little bit of pressure in the back half of the year. But we think we are well positioned, both from a contractual basis and an inventory basis, vis-a-vis the competitive situation.

Amit Daryanani - RBC Capital Markets - Analyst

Got it. Just one touch on these -- HP has always made a big focus on using industry standard components, developing new products on an industry side of component architecture. What percent of the total products have actually run on industry-standard product? And how might you kind of translate that strategy into ProCurve (inaudible) or 3Com?

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

Yes. So more or less, and it's hard to do this with surgical precision, but we say more or less, the ProCurve products are about 70%, industry standard. The business-critical server products are about 70%. The industry standards servers are about 80%. And more or less the PCs are largely built on standards in the mid to high 90%. So, that's kind of the benchmarks of where we are, and our intent is to drive that farther.

But for that 70%, as we centralize the procurement of those components that comprise that 70% for ProCurve, for example, and we have the scale of the whole Company including the PC company and we compete with competitors that don't have similar scale that are doing the same things in the server space or the networking space, we believe that gives us an advantage.

Amit Daryanani - RBC Capital Markets - Analyst

How will that be for 3Com? I'm just curious. ProCurve you said 70%. Is 3Com (multiple speakers)?

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Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

I don't know. I don't know. I don't know enough to comment. I don't know enough to comment. So I haven't personally looked at it on 3Com, so I wouldn't certainly offer a comment on that. But conceptually and directionally, I think a strategy would be the same as it has been for ProCurve.

Amit Daryanani - RBC Capital Markets - Analyst

Got it. On the topic of consolidating nodes and integrating IT infrastructure and everything, you guys obviously have a very wide supply chain. In terms of ODN, EMS, Windows and so on. Is there a strategy to consolidate that part at all or are you content with (multiple speakers)?

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

Yes, no. No, no, there is a strategy to use fewer -- whatever it is -- logistics providers, transportation providers, freight forwarders, ODMs, EMS or commodity providers. Our strategy is to -- because otherwise how do you take cost out? It's just simply -- I want your margin, I want your margin to come to [mine] -- versus I'm going to consolidate into your fixed costs and you're going to actually be able to have lower costs because I've consolidated volume and taken the long tail and played into a smaller basis. And that's how you generate real value without just simply back-and-forth moving margins around. So the short answer to your question, yes; there is a strategy to have a smaller base over time, over time.

Amit Daryanani - RBC Capital Markets - Analyst

We'll just find out if there are any questions in the audience. I don't know if there's a mic. going around somewhere or if you can get a mic? If you just want to yell it out I'll repeat it to the audience.

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

You also -- you probably could turn the house lights up as well. Please.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

It's an important balance. I think the leadership of the Company is acutely aware of the issue that you appropriately raised. And again, when we say we're going to standardize, it's important to note we have standardized. So we have a significant level of standards. But then we continue to innovate with solutions like Virtual Connect, which might be a software solution way to innovate and create value on top of industry-standard hardware. So it's a good question.

We struggle with that. We think we have our arms around it. We think we continue to drive innovation broadly into the market even though we have built a base of -- you don't get innovation by having a unique power supply. That's a one-off, right? That doesn't create value for customers, and it creates unique fixed cost and scaled diseconomies. So we're focused on those sorts of things, memory etc. And if there's specific hardware things, ASICs and those things that do create value then naturally we develop those design nodes or partner to create those.

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Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Tony Prophet - *Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG*

No, actually -- clearly we have been a leader in the mobile computing space and we see that the trend of connected mobile devices as an important megatrend and one that will be a growing market -- maybe growing above trend for the foreseeable future. So we are focused on being a significant player in that space from smartphones, Slate or tablet-type PCs, netbooks and other connected devices. As well as new forms of connected devices, like Web connected printers.

Our focus in this space is an important part of the rationale for our strategy to acquire Palm, which is not yet closed but that is an important part of our strategy.

Unidentified Audience Member

Just a couple of questions around inventory management. On the raw materials side, you have components costing from \$0.10 to \$100. So what's your strategy of inventory? How many days do you keep of these components depending on the price? I would think that for processor, memory or graphics, those are probably just in time, but for the discrete capacitors into the sort of \$0.10, \$1; you keep those for several months of inventory. Can you talk about that a little bit?

Tony Prophet - *Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG*

Yes, I'll comment on that. And again, quarter over quarter and year over year, our inventory performance has been relatively flat at about 25 days for the Corporation. For those smaller passive components that you highlighted like diodes and capacitors and resistors, typically, typically, HP does not buy those components. Okay? So we typically buy strategic components. So we buy, only buy, memory, microprocessor, hard disk drive, chipset, those strategic components. And the passive components, those lower-cost components, we don't transact in those at all.

So for the strategic components, our strategy has been for the ones that have a high volatility to at times have strategic inventory purchases, right? So and memory and panels are good examples of where that may make sense. And so at times, if we think the price is attractive, we will buy it -- we will make a strategic purchase, and generally, to make sure that we don't run out of material, we generally have some inventory of those strategic components, particularly the memory in the panels.

Now, looking back, I think you've heard our competitors over time, many people talking about the sort of model you are talking about, kind of the just-in-time, pull it every hour approach to things. And as we went through the booms and busts of the past few years, I think that didn't work out so well. And we had been deploying a strategy that I highlighted earlier of being off the spot market, of having some strategic inventory, of not being just-in-time for those key components to protect our share. And also we thought it helped us to get better pricing at times. So we had it both for assurance of supply as well as for effective pricing. We think it served us well over the time period that some of the charts behind me had reflected.

Amit Daryanani - *RBC Capital Markets - Analyst*

Great. You're still on that same [node out], and you guys don't disclose this number [quite] exclusively, but it's very common for all the [waves] to have a certain level of purchase commitments to the entire supply chain every quarter. I'm curious, has that number actually gone up for you guys over the last few quarters? And if so, any sense of the magnitude that it's going up by?

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Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

Well, if you started the question we usually don't disclose this, step on this landmine. But what I would say is it doesn't actually go up as our revenue grows. So if you think about inventory in terms of days and if your revenue is growing and ours did, our revenue grew 20%, 20%, 21% year over year then if you had the same amount of days it would naturally go up.

Amit Daryanani - RBC Capital Markets - Analyst

Maybe one topic that would be very helpful to discuss is just -- given all the macro issues that you're seeing in Europe, I'm curious just to a broader degree if you guys are seeing any impact out of that and how do anticipate that playing out, especially from the PC side, right? Are you seeing retail channels actually deplete inventory more aggressively at this point because you're worried about what demands does and [normally what's carrying] inventory in Europe right now?

Cliff Wagner - Hewlett-Packard Development Company, L.P. - IR

I think from a macro basis as we have mentioned in the second quarter, I think we got a lot of questions in regards to how do you look at Europe and what did you see in Europe as we exited Q2? I would say first of all the second quarter as we exited was one of the first quarters that we really saw above normal seasonality across the board, including in Europe.

And it wasn't just -- what we had been seeing is maybe one country does well or you see a good pocket of countries doing well. This was broad-based. This was multiple countries in Europe that were above normal seasonality. It was not only broad-based across the number of countries. It was also broad-based across the segment. So whether it be in PSG or in ESS, etc., saw pretty broad-based improvement in Europe as we looked at a sequential basis.

Now, as we went in and looked at guidance, as we guided into Q3 and in the full year, and obviously we did as many checks as we know how or we looked at the demand picture and we ultimately guided to a normal seasonal pattern as we exited Q2. But it was really, Amit, to your point, it was broad-based. And even as some of our competitors have been coming out and talking to some of our peer groups and so forth, we'll just have to see. But what we saw coming out of Q2 was pretty strong.

Amit Daryanani - RBC Capital Markets - Analyst

Tony, just from your perspective, the Europe retail channel side, in Q2, how were the inventories over there? Were they a little bit more higher than normal? Were they a little bit lower?

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

As we exited Q2, we feel comfortable the way that we exited Q2 [channeling 3].

Amit Daryanani - RBC Capital Markets - Analyst

Are there more questions in the audience?

Unidentified Audience Member

How much is the shipment time from China to here by water? And so how many -- you probably changed the percent of air shipment versus water shipment. How does that get decided and how many days of inventory -- finished product do you have to keep because of that shipment?

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Tony Prophet - *Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG*

So for shipping -- and you're talking specifically about notebooks because desktops are -- we have maybe a different strategy than some of our competitors for desktops. We build desktops both in China and in the region. So we build desktops in the United States and in Mexico and in the Czech Republic and India, etc., right? So and we build them in China and ship them.

So for notebooks, which are principally built in China, not exclusively, the transit time by ocean, port to port is about 20 days to Long Beach, and to Rotterdam is about 39 or 40 days.

So to specifically answer your question, the -- and the air shipment time is three or four days, including customs clearance, more or less, more or less.

And so we consistently adjust those knobs. And generally, if you look at the multiyear trend, back in 2006 to today, we have been -- generally been turning the knob up, more sea shipments, less air shipments. And so historically, it was low, less than 10%. We're probably now 20% more or less. So we've been consistently turning the knob up, more sea shipments, less air shipments. And obviously you get the cost of volatility of air freight because of jet fuel. And that has we think played to our advantage. And the ability to have that knob, to turn it up and down depending on what's happening to managing inventory, or to manage costs I would think is a pretty effective lever for us.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Cliff Wagner - *Hewlett-Packard Development Company, L.P. - IR*

I think Tony mentioned it earlier before. As we exited Q2, we saw pretty strong growth in commercial clients. Commercial client revenue and PSG was up 19%. We saw workstations up 47%. So I think from a corporate refresh standpoint, we see some of that happening. Now we also see kind of the consumer being strong, the SMB segment. But you are seeing some of that in the corporate enterprise.

As we look to Q3, we don't see -- or we are not necessarily modeling from an outlook standpoint or from a guidance, a significant uptick versus normal seasonality. But, as we see it come back, we feel like we're pretty well prepared to take advantage of it.

You also have to remember, over the last several years, our position has changed significantly. If you look at like the IDC numbers for example last quarter, we gained 8 points of share I believe in the corporate enterprise space. So we are continuing to improve our position, so as this refresh happens, we'll be in a position to take advantage of it.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Cliff Wagner - *Hewlett-Packard Development Company, L.P. - IR*

I think clearly Win 7 is a positive thing. Don't get me wrong. At the same time, we've continued to see a very aging installed base. And if you look at 2009, as people really put off purchasing new equipment in 2009, whether you're talking about printers, you're talking about PCs, you're talking about servers, it was a pretty slow year across the board. As that has now been pushed out, some of that is coming back into the process in 2010, and we expect that to continue. I think that we are still in kind of early stages of the refresh.

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Amit Daryanani - RBC Capital Markets - Analyst

Okay. So maybe we have time for a couple more questions. One from my side is really -- two years ago, the big phenomenon I think was netbooks and you saw a big proliferation of that from Acer and Asus and those guys. Seems like the (inaudible) is tablet. Just from a supply chain perspective or component sourcing perspective, how different is a tablet to a regular notebook? And if you can just [side] for that whole process, how much of what you do (inaudible) because of the supply chain side for you guys to build a notebook from the supply chain side, having Web OS on it versus Windows 7 over Windows Vista or whatever -- Windows OS [views]?

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

So if you compare -- if your question was comparing a tablet to a notebook or netbook, and how is it different?

Amit Daryanani - RBC Capital Markets - Analyst

Yes, and especially with I guess Web OS, because one of the things in my head I always think about Web OS is it's built for portable devices. Essentially that means I would assume it uses a whole lot less memory than (inaudible) desktop operating system (multiple speakers). So, is that a fair assumption?

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

So the Palm acquisition is not closed. So we need to be careful to comment too much about any future intentions in terms of (multiple speakers). Generally -- what you can think generally though is an operating system like Web OS is less memory intensive. Less memory intensive. And what you can say generally about the space of the tablet/Slate space is the products that we have seen and that you do see have less storage on them. They tend not to have big, big hard drives. They tend to have more [solid state] storage. It's probably the key. I'm just observing what's happening -- key observational difference.

Amit Daryanani - RBC Capital Markets - Analyst

And so, when we think of HP and all the scale that you guys have on the PC side, that absolutely should help you lower the cost of manufacturing the tablet, right?

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

We would expect that the strategies that we have, that have served us well in the PC space, that the commodity and a prospective tablet space aren't materially different. And we would expect those strategies to -- we would expect them to work there as well.

Amit Daryanani - RBC Capital Markets - Analyst

You know what, I think we're almost out of time, so don't know if you guys have any closing comments. If not, thanks a lot.

Tony Prophet - Hewlett-Packard Development Company, L.P. - SVP of Worldwide Supply Chain Operations of PSG

We think we appreciate your attention and attendance and this opportunity to share more of the HP story with you. So, thank you.



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