

# FINAL TRANSCRIPT

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## **HPQ - Q3 2010 Hewlett-Packard Earnings Conference Call**

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Aug. 19. 2010 / 10:00PM, HPQ - Q3 2010 Hewlett-Packard Earnings Conference Call

## CORPORATE PARTICIPANTS

**Jim Burns**

*Hewlett-Packard - VP IR*

**Cathie Lesjak**

*Hewlett-Packard - CFO, Interim CEO*

**Ann Livermore**

*Hewlett-Packard - EVP, Enterprise Business*

**Vyomesh Joshi**

*Hewlett-Packard - EVP - Imaging & Printing Group*

**Todd Bradley**

*Hewlett-Packard - EVP - Personal Systems Group*

**Toni Sacconaghi**

*Sanford C. Bernstein & Co. - Analyst*

## CONFERENCE CALL PARTICIPANTS

**Brian Alexander**

*Raymond James - Analyst*

**Ben Reitzes**

*Barclays Capital - Analyst*

**Richard Gardner**

*Citigroup - Analyst*

**Keith Bachman**

*BMO Capital Markets - Analyst*

**Katy Huberty**

*Morgan Stanley - Analyst*

**Shannon Cross**

*Cross Research - Analyst*

**Scott Craig**

*BofA Merrill Lynch - Analyst*

**Bill Fearnley**

*Janney Montgomery Scott - Analyst*

**Mark Moskowitz**

*JPMorgan - Analyst*

**Abhey Lamba**

*ISI Group - Analyst*

**Jeff Fidacaro**

*Susquehanna Financial Group - Analyst*

**Aaron Rakers**

*Stifel Nicolaus - Analyst*

**Amit Daryanani**

*RBC Capital Markets - Analyst*

## PRESENTATION

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**Operator**

Good day, ladies and gentlemen. Welcome to the third quarter 2010 Hewlett Packard earnings conference call. My name is Michael and I will be your conference moderator for today's call. At this time, all participants are in a listen only mode. We will be facilitating a question and answer session towards the end of the conference.

(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. Jim Burns, Vice President of Investor Relations. Please proceed.

**Jim Burns - Hewlett-Packard - VP IR**

Good afternoon. Welcome to our third quarter earnings conference call, with Cathie Lesjak, CFO and interim CEO, Todd Bradley from the Personal Systems Group, Ann Livermore, from HP's Enterprise business, and VJ, who runs the Imaging and Printing Group. This call is being webcast. A replay of the webcast will be available shortly after the call for approximately one year.

Some information provided during this call may include forward-looking statements that are based on certain assumptions that are subject to a number of risks and uncertainties and actual future results may vary materially. Please refer to the risks described in HP's SEC reports, including our most recent Form 10-Q. The financial information discussed in connection with this call, including tax-related items, reflects estimates based on information available at this time and could differ materially from the amounts ultimately reported in HP's third quarter Form 10-Q.

Earnings, operating margins and similar items at the Company level are sometimes expressed on a non-GAAP basis, and have been adjusted to exclude certain items including amortization of purchase intangibles, restructuring charges and acquisition related charges. The comparable GAAP financial information and a reconciliation of non-GAAP amounts to GAAP are included in the tables and the slide presentation accompanying today's earnings release, both of which are available on the HP Investor Relations web page at HP.com. With that I'll now turn the call over to Cathie.

**Cathie Lesjak - Hewlett-Packard - CFO, Interim CEO**

Good afternoon, and thank you for joining us. Q3 was another strong quarter of profitable growth for Hewlett Packard that highlights our consistent broad-based performance. We grew revenue 11%, expanded operating margins 30 basis points versus the prior year and grew non-GAAP EPS by 17% to \$1.08. HP is a trusted partner with strong relationships across its customer base. Our portfolio, made up of hardware, software and services is winning today, but more importantly, our customers recognize HP's position for the future in the data center and converged infrastructure, in connected and mobile devices, in our imaging portfolio and in the breadth of our services offerings.

In Q3, we had balanced geographic performance with revenue in each region growing faster than normal seasonality. Americas was up 12%, EMEA up 9% and Asia Pacific grew 14%. We saw solid growth across both developed and developing economies. Our Q3 results also demonstrate good balanced growth across IPG, PSG, and our enterprise business, with solid double digit growth in our hardware businesses. We are capitalizing on commercial spending with ISS revenue up 31%, storage up 10%, ProCurve up 42%, IPG commercial up 28% and PSG commercial up 25%. Additionally, we experienced strong services signings in the quarter, and increased enterprise services hardware revenue pull through by over 50%.

On the expense side, we continue to aggressively improve our productivity. We have significant savings still to be captured in our services, supply chain and real estate initiative. At the same time, we are increasing our investments in R&D and sales and marketing. We see attractive opportunities to take our portfolio to the next level and are focused on increasing our coverage of the \$1.3 trillion market.

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Before discussing our detailed financial results, let me just summarize our unique position in the market and our sustainable competitive advantages. As our results demonstrate, we continue to leverage our scale and reach to serve customers around the world and drive increased productivity. We are using our financial strength to make balanced investments in growth, efficiency, and in effective capital structure. We are delivering leading technologies, products, and solutions to our customers, and we will continue to leverage our talented management team to deliver consistent execution.

Now let's take a deeper dive into our numbers, beginning with the P&L. Revenue for the third quarter totaled \$30.7 billion. We added \$3.1 billion to the top line, delivering 11% growth including almost 1 point of favorable currency impact. This was the strongest constant currency growth since 2008. The third quarter gross margin was 23.8%, up slightly from the prior year and up 30 basis points sequentially.

Operating expenses increased 10% to \$3.9 billion as we accelerated investments to drive long term growth including increases in R&D and building out our enterprise sales force. Excluding the impact of the DOJ legal settlement, operating expenses increased 8%. Non-GAAP operating profit increased 14% year on year to \$3.4 billion, with operating margin expansion of 30 basis points. Other income and expense yielded a net expense of \$135 million, due primarily to currency losses. Non-GAAP net income improved to \$2.6 billion and non-GAAP diluted earnings per share increased 17% to \$1.08, including the charge of approximately \$0.02 relating to the previously announced Department of Justice settlement.

Looking at the details of our performance by business. Revenue in the imaging and printing business grew 9% to \$6.2 billion, fueled by year-over-year unit shipment growth of 16% and supplies revenue growth of 5%. Commercial hardware revenue increased 28%, while consumer hardware revenue grew 4% compared with the prior year quarter. Segment operating profit totaled \$1 billion, or 16.9% of revenue.

We continue to lead the market with innovative new products. In June, we launched the ePrint platform and the ePrintCenter and announced we were expanding our portfolio of web-connected printers to include all printers above \$99. This strategy is driving success with third quarter consumer Inkjet hardware shipments up 9% year-over-year, led by 64% growth in wireless printers and OfficeJet growth of 16%.

In addition, our retail publishing footprint continues to expand both in the US and across the world. Commercial printer unit shipments grew 44% with strong mono and color laser shipments as hardware availability improved significantly from the prior quarter. We continue to see strong momentum in our growth initiative in the enterprise and commercial print market, both graphic arts and managed printer services grew double digits. Multi-function printer shipments increased 47% over the prior year period, and HP Indigo Digital Press page volume was up 22%. We will continue to aggressively target these markets, leveraging our technology leadership to drive the shift from analog to digital printing.

Turning to Personal Systems. PSG revenue increased 17% from the prior year to \$9.9 billion with total unit shipments growing 12%. Segment operating profit totaled \$469 million or 4.7% of revenues as PSG continues to deliver solid performance driven by our innovative product portfolio, scale and global reach. Notebook and desktop revenue were up 10% and 27% respectively, and workstation revenue increased 54%. This strong workstation performance was driven by our new products with their attractive price performance.

PSG average unit prices increased 5% from the prior year and 1% sequentially. Our initiatives to extend our position in the commercial segment are paying off with commercial client revenue increasing 25%. Our market leadership in commercial PCs and continued share gains in the US enterprise segment position us well for the PC refresh cycle that we are seeing in both SMB and corporate enterprise. Finally, we are pleased to have closed the Palm acquisition at the beginning of July, which gives us the ability to leverage the Web OS in a variety of connected mobile devices.

Services delivered revenue of \$8.6 billion, up 1% from the prior year, within services, application services increased 4% with growth coming from both new customer accounts and the installed base. IT outsourcing and business process outsourcing each increased 1% and the Technology Services business declined 1%. We had strong growth in signings due to renewals by



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some of our largest customers, and the trailing 12 month book-to-bill remains comfortably greater than 1. As I indicated earlier in my remarks, we are also seeing more HP product pull through into our enterprise service accounts and we expect this trend to continue. Services segment operating profit in the quarter increased to \$1.4 billion or 15.9% of revenue, up 60 basis points from the prior year, driven by improvements in service delivery.

HP software revenue was \$863 million, up 2% when compared with the prior year. BTO increased 3%, led by growth in license revenue. The software business expanded its operating margins by 310 basis points to 21.2%. On Tuesday of this week, we announced an agreement to acquire Fortify Software. This addition to HP's portfolio complements our existing Dynamic Application Security Solution and strengthens our leadership position in application and information security.

Enterprise storage and server revenue was \$4.4 billion, up 19% compared with the prior year with balanced double digit growth across every region. This quarter the business delivered \$549 million in operating profit and an operating margin of 12.3%, an increase of 210 basis points from the prior year. The ESS results were driven by strong performance in ISS and ESS Blades, which grew 31% and 29% respectively. Storage revenue increased 10% from the prior year with triple digit growth in our Scale-out iSCSI products based on technology acquired from LeftHand Networks. Business critical systems revenue declined 15%, ahead of our new Superdome products, which start shipping in Q4.

This quarter we launched several new products in ESS. In June we introduced new ProLiant G7 servers, significant enhancements to Blade system offerings, and our new Smart Grid technologies which increased the energy benefits for customers by making the data center more efficient. Finally, in July, we expanded our storage offerings with the launch of our StoreOnce deduplication product developed by HP Labs.

Turning to our networking business. With the close of 3Com in Q2, we are accelerating our investments in networking, HP networking, which is reported in the corporate investment segment recorded organic growth of 42%, or total growth of 198% including 3Com, which was ahead of plan. In the last 90 days, we have seen significant interest in our HP networking data center solutions. 300 of our top 1000 customers have initiated proof of concept.

Among the customers deploying HP networking solutions this quarter are Marriott, Dreamworks and the US Department of Health and Human Services. HP Financial Services continues to deliver very strong consistent results. In the third quarter, financing revenue grew 14% to \$764 million, and generated operating margin of 9.4%, up 150 basis points from the prior year.

Now on to the balance sheet and cash flow. Our balance sheet remains strong with solid working capital management. We closed the quarter with total gross cash of \$14.8 billion. Our third quarter cash conversion cycle was 17 days, down 1 day from a year ago with days sales outstanding down 2 days, inventories up 3 days and days payable up 2 days.

Channel inventories in ESS and IPG are in good shape. PSG channel inventory is a few days higher than we would like and we expect to bring it down in Q4. We generated operating cash flow of \$3.3 billion and free cash flow of \$2.2 billion. During the third quarter, we returned \$2.6 billion to shareholders through share repurchases, and reduced our weighted average shares outstanding by 30 million sequentially. At the end of the quarter, we had roughly \$4.9 billion remaining in our current share repurchase authorization, and we expect to remain active in our shares through the end of the fiscal year. Finally, we paid dividends totaling \$205 million.

And now, a few comments on our outlook for the fourth quarter and the full year. We expect Q4 fiscal 2010 revenue to be \$32.5 billion to \$32.7 billion. Included in this outlook is approximately 1 point of negative currency impact compared with the prior year. For the full year, we are raising our outlook to \$125.3 billion to \$125.5 billion, up approximately 9.5% from the prior year.

Regarding earnings, there are a few variables to keep in mind. We will continue to fund investments to drive long term growth initiatives. We expect OI&E expense of about \$0.05 per share, a tax rate of approximately 22% and a sequential decline in weighted average shares outstanding similar to what we drove in the third quarter. With that in mind, we expect fourth quarter



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non-GAAP EPS in the range of \$1.25 to \$1.27. For the full year we are raising our outlook and now expect non-GAAP EPS of \$4.49 to \$4.51, representing growth of approximately 17% for the fiscal year.

In summary, we feel good about our broad based performance in Q3. We are well positioned in the market and our full year outlook reflects our strength and ability to execute. With that, we will now open the call for your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Your first question comes from the line of Brian Alexander of Raymond James. You may proceed.

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### Brian Alexander - Raymond James - Analyst

Thank you. Good evening. Cathie, you mentioned increasing investments in R&D and sales and marketing in your prepared remarks. It seems like a quite a few investors believe the next CEO might decide to noticeably step up the pace of investment as they assume the Company has systematically underinvested in recent quarters, so the concern is this would create near term margin pressure and perhaps even a reset of earnings expectations, so I'm just wondering if you could address the premise that HP has been underinvesting and do you plan to reflect the possibility of the next CEO investing more aggressively when you provide the FY 2011 outlook at your analyst day?

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### Cathie Lesjak - Hewlett-Packard - CFO, Interim CEO

Brian, we have not underinvested in R&D, I think is probably the short answer to that and we've got a number of proof points and I'll actually ask in a minute Ann and VJ to comment on that, but I think what's important is to think about the fact that we've got three year plans out there. Three year plans that are supported by the Board, that include acceleration in both R&D and sales to drive growth and that those investments are funded through the vast number of productivity initiatives that we've got kind of in flight already plus those are still to come that give us a real opportunity to not only grow healthy, have healthy growth, but also grow EPS even faster than revenue growth, so I don't think that there's an issue there at all and maybe I'll ask again Ann and VJ to comment on some of the R&D investments that we've made and the success we've had there over the last few years.

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### Ann Livermore - Hewlett-Packard - EVP, Enterprise Business

Sure, well if you look at Q3, just during the quarter, we had a set of product introductions for the enterprise server, storage and networking business that was the largest quarter ever, and this is the result of R&D investments that have been made quarters and years in advance. We announced in June or launched in June, the G7 server for a new offering in our ProLiant family. We had significant enhancements that were made to our Blade Systems offerings and you also saw a whole new smart grid technology that we introduced and this is focused on helping clients be able to improve the energy efficiency of their data centers. On top of all that, we also launched StoreOnce which is a deduplication product that was created in HP Labs and then brought through my Product Development team, and this offering is twice as good as anything else in the market from a price performance perspective for deduplication, and then just to crown it all off, we had our networking business with HP ProCurve which we've been investing in from an R&D perspective, growing 42%, so I think all of those things are a sign of the R&D that we've been doing and we'll certainly continue to do.

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**Vyomesh Joshi** - Hewlett-Packard - EVP - Imaging & Printing Group

Brian, this is VJ. At IpeX, we introduced our next generation of Web Press, we got a phenomenal feedback. On June 6, we introduced all of our new web connected printers, that below \$99, every single printer will have an e-mail address and you could see the results. We gained two points of market share in Inkjet. We had 16% unit growth in every single category, we are increasing our market share so from an innovation point of view, we are on fire. As a matter of fact, the feedback that we get that the product portfolio that we have right now is the best in the last six years.

**Brian Alexander** - Raymond James - Analyst

Thank you for the detailed response.

**Jim Burns** - Hewlett-Packard - VP IR

We'll take the next question please?

**Operator**

Your next question comes from the line of Ben Reitzes of Barclays Capital. You may proceed.

**Ben Reitzes** - Barclays Capital - Analyst

Yes, thanks. Could you talk a little bit about what you're seeing in the businesses from this context? I mean, I think some might be surprised that a lot of the revenue upside was in PCs and services versus my model and obviously there's been strength in enterprise and there's been strength in printers for some, and I just would have thought maybe supplies or some of the other things might have picked up more. I was wondering if there's shortages there and if you could just talk about the segments a little more because I think PCs were a lot better than expected and services revenue as well, and some of the others look like there might still be some shortages and what not heading into the next quarter.

**Cathie Lesjak** - Hewlett-Packard - CFO, Interim CEO

So Ben, in terms of supplies growth, so we had 5% supplies growth year-over-year and on a constant currency basis that was 8% supplies growth, so still, quite strong supplies growth and as we've talked most of this year, we have this roughly three points of currency headwind and we see that continuing into Q4, so if you think about supplies growth, we think about it in terms of kind of reported mid single digits and on a constant currency mid to high single digits for Q4.

**Ben Reitzes** - Barclays Capital - Analyst

And was there still constraints in the quarter?

**Vyomesh Joshi** - Hewlett-Packard - EVP - Imaging & Printing Group

No, I think-- this is VJ, Ben. There are no constraints. I think the LaserJet you can see 44% unit growth that we delivered and clearly, we have a tremendous demand here. The LaserJet brand is fantastic, and we are expecting in fourth quarter at least 30% unit growth for the LaserJet, so we believe that the demand is strong, we continue to get out of the availability and in the supplies, you'll also remember that we are gaining share against refill and reman so we are really driving our supplies sell out,

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we absolutely believe that putting more units now and valuable units and with web connectivity and the stuff that we are doing with ink in the office we will continue to see very good growth.

**Todd Bradley** - *Hewlett-Packard - EVP - Personal Systems Group*

Ben, this is Todd Bradley. I'd just add to VJ's comments. In our commercial markets, we gained about 8 points of share in the US enterprise and we're seeing very, very good pull through from our enterprise services. Our ASPs were up 5% and I think that demonstrates that customers are willing to pay for new and innovative products that we're bringing to the market.

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

Thanks, and I'll sneak another in there. Cathie, can you just talk about the inventory in the quarter up 12%? Does that mean that you're expecting a big Q4 or were you happy with that number?

**Ann Livermore** - *Hewlett-Packard - EVP, Enterprise Business*

So I'm happy with the way we ended inventory. It was up three days year on year and it was up for all good reasons so there are three main reasons. There are three main reasons. The first reason was better laser availability and the second one was we're putting more inventory on sea, especially in the PC category which gives us a cost advantage and then the third is that we've had good response, good growth in our pod business which is basically data center in a container and obviously it takes more inventory to buildout an entire data center before you ship it, so I'm very comfortable of where the inventory landed.

**Jim Burns** - *Hewlett-Packard - VP IR*

Great. Thanks. We'll take the next question please?

**Operator**

Your next question comes from the line of Richard Gardner of Citigroup. You may proceed.

**Richard Gardner** - *Citigroup - Analyst*

Okay, great. Thank you. I was hoping, Cathie and perhaps Todd you could talk about what's going on in the PC business, giving the sharp deceleration in unit growth that we saw in the quarter, I think this is the first quarter where you've lost market share in a number of years so I'd just be curious to get your sense of whether this is more of a market situation or whether there were significant Company specific events that took place during the quarter as well and what your view on when you can get back to sort of a market rate of growth or better is there. Thank you.

**Todd Bradley** - *Hewlett-Packard - EVP - Personal Systems Group*

This is Todd. The yardstick I use for PSG has been in remains profitable growth. As you heard Cathie report, we had very solid revenue growth this quarter at 17% and I think very good profitability. We had 4.7%. There is bad business to chase in the PC market, if market share is your primary and your only goal. That's not what we're working on.

Our scale, our global footprint, frankly the flexibility in this business will continue to be competitive differentiators for PSG and for HP overall. I think the other point I'd make to repeat what I'd said to Ben's comment was we saw strength in our commercial markets. We gained eight points of share in the US enterprise where we're seeing very, very good pull through from our enterprise

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services, our ASPs were up 5% demonstrating customers' willingness to pay for both innovative products and high quality products.

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**Richard Gardner** - Citigroup - Analyst

Todd, could you characterize what you're seeing in the consumer PC market currently? Thank you.

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**Todd Bradley** - Hewlett-Packard - EVP - Personal Systems Group

Well, we saw some softness in our consumer notebook market and I call it consumer notebook market, I think back-to-school started somewhat late for us but we certainly have seen it start, so I think a soft beginning but overall we're seeing things are on track.

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**Operator**

And your next question comes from the line of Keith Bachman of Bank of Montreal. You may proceed.

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

Hi, thank you. I wanted to ask Cathie and Ann about the services business, and the focus of the question is really what's the growth rate potential, the revenue growth was up about 1%, my guess is probably flat on constant currency basis and yet the operating margins were about flattish over the last couple quarters. Is this and can it be a growth business, and then how does the remaining cost opportunities play out against that growth potential, thank you.

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**Ann Livermore** - Hewlett-Packard - EVP, Enterprise Business

As we look at the third quarter, it was a record signings quarter for us and as you know, this business is driven by having solid pipelines that have quality deals as well as good quantity of deals, so we feel good about the pipeline that we have. We feel good about the record signings that we had this quarter that was driven both by good renewals as well as some new signings, and then when we look at the trailing 12 month signings and also the book-to-bill ratios, we feel that both of those are healthy numbers so we feel good about all those things.

As we're finishing up with the first phase of the integration of EDS into HP, what we're doing now is increasing some of our sales resources and also seeing a very nice improvement in the pull through, so we care about our overall product position and our ability to sell more products as well as the ultimate growth of the services business itself. We do expect that we're going to be able to have this business at a point where it can outgrow the market, and that's going to be based on the sales coverage improvements we're making, as well as some offering adjustments that we're making. When you look at the margins part of your question, we performed right at the mid point of what we said our guidance was of 15 to 17%, so it was 15.9%, we were right at the mid point. We were up 60 basis points year-over-year and yet, we feel like even though we're at that range already, there's still a lot more work for us to do.

Back in June at the beginning of the month, we announced a new transformation initiative that we believe can take Enterprise Services to the next level and what we communicated to you then was that those activities we were doing around consolidating data centers, doing more tools deployment, driving more automation, reducing layers, that all these things could generate \$500 million to \$700 million of net savings by the end of FY 2013, so we still feel very optimistic about those numbers that we gave you, and then on top of it all, as you know, having great costs allow you to price more aggressively and at the same time deliver good margins, so we're always going to be working on the cost to achieve that, so we feel good about where we are at this point and believe there's a lot of improvement still yet to do in the business.



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**Cathie Lesjak** - *Hewlett-Packard - CFO, Interim CEO*

And let me just take it just a tiny bit more tactical and just talk about the fact that in Q3, it was a bit of an investment quarter for us and that you should see that the transformation starts to kick in in Q4 and you'll see an uptick in margins starting in Q4.

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

Thank you, Cathie and Ann.

**Operator**

Your next question comes from the line of Katy Huberty of Morgan Stanley. You may proceed.

**Katy Huberty** - *Morgan Stanley - Analyst*

Thanks. Cathie, this is one of the strongest gross margins for the Company in a number of years. Given the relative strength you're seeing in enterprise versus for instance consumer PCs which are lower margin and what's going on in the component cost environment, any reason to believe that this level isn't sustainable or you couldn't even grow off this base?

**Cathie Lesjak** - *Hewlett-Packard - CFO, Interim CEO*

Katy, a couple things. First off, the normal sequential pattern for gross margin is Q4 margins tick up from Q3 and we don't expect any different pattern this year. On top of that, the acquisitions, the recent acquisitions that we've closed and/or announced are very positive for margins. For example, a lot of the strength in our gross margin this quarter came from the networking business both in terms of increasing the mix, ProCurve grew 42% year-over-year, obviously we also added 3Com to the mix, but also just rate improvements in that business as well.

**Katy Huberty** - *Morgan Stanley - Analyst*

Got it and then if I may, just a quick follow-up for Todd. You mentioned the consumer notebook weakness which may be partially attributed to strong tablet sales. When would you expect HP to participate in that category?

**Todd Bradley** - *Hewlett-Packard - EVP - Personal Systems Group*

Well, as we look at tablet sales, it's late sales. That was a big part of the reason we acquired Palm. You'll see us with a Microsoft product out in the near future and a Web-OS based product in early 2011.

**Katy Huberty** - *Morgan Stanley - Analyst*

Thank you.

**Operator**

Your next question comes from the line of Shannon Cross of Cross Research. You may proceed.

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

Thank you for taking my question. Cathie, can you talk a bit about what you're seeing from a government standpoint in terms of impact from austerity or perhaps even more demand out of the government as they look to outsource more, and then I have a follow-up, thanks.

**Cathie Lesjak** - *Hewlett-Packard - CFO, Interim CEO*

Shannon, public sector business for us was solid in some countries this quarter and a little bit tougher in some other countries like the UK. It wasn't really a material driver of strength or weakness in the quarter. We did see strong signings in basically our US public sector business, and I think what's really important in this space plus in other, in the commercial space is the economic value proposition of some of our products. I think that that makes a huge difference, when you can show a customer whether it's public sector or otherwise that you've got a very strong return on the investment or you have a huge value proposition in our networking business, I think that will really help us in this area.

**Ann Livermore** - *Hewlett-Packard - EVP, Enterprise Business*

If you look at our networking business in particular, we were very pleased not just for the public sector customers but more broadly. When you've got a product like what we've got now between 3Com and ProCurve we have a really strong value proposition. The networking market has been one characterized by high prices, proprietary products and little choice, and now that HP's got the offering we have, we've just seen a very strong demand for the products and we're able to offer our networking products at a very attractive price and yet at the same time generate a very attractive margin.

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

Great, and then Cathie, if you can just talk a little bit about share repurchase. If I heard right during your commentary it's similar in terms of cash usage in fourth quarter, but I'm just curious given what's happened to the share price if you're looking at possibly accelerating even more in terms of the shares you buyback or just in general sort of what are your thoughts, thanks.

**Cathie Lesjak** - *Hewlett-Packard - CFO, Interim CEO*

Shannon, in Q3, we accelerated our share buybacks pretty significantly. We spent \$2.6 billion in share repurchases in Q3, up from \$1.8 billion in the previous quarter and we do expect to continue to be active in our shares, and I think it's also important to note that our option overhang has come down very significantly and it now represents roughly 6% of the shares outstanding which is about half of what it was three years ago. The importance of that of course is that the cost of maintaining zero dilution and offsetting dilution from employee benefit plans has come down very significantly and there for, when you spend \$2.6 billion in a quarter, it goes heavily to getting shares off the table, and we do expect as I mentioned in my prepared remarks that you should model about a 30 million share decline from Q3 to Q4 which is about what we saw from Q2 to Q3.

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

Great. Thank you.

**Operator**

Your next question comes from the line of Scott Craig of Banc of America Merrill Lynch. You may proceed.

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**Scott Craig** - BofA Merrill Lynch - Analyst

Yes, thanks, good afternoon. Cathie, to start on the services business you mentioned you thought margins were going to start to uptick next quarter but can you maybe give us an outlook for when you think the revenue growth starts to accelerate given how well you've done on the bookings and just with regards to the fourth quarter guidance overall you've done a number of acquisitions and the business mix is changing so how do you view normal seasonality now in the fourth quarter and your guidance relative to that, thanks.

**Cathie Lesjak** - Hewlett-Packard - CFO, Interim CEO

In terms of the services, what we're working on as I think Ann mentioned is getting our cost structure right, and once you get your cost structure right you have that opportunity to bid much more competitively and we're starting to see that in the strong signings and the pipeline, so given those cost structure improvements, coupled with the investments we have been making in sales coverage as well as innovative services offerings we expect to outgrow the market in the long term and be closer to the market, we expect the market to uptick a bit but to be at market in 2011 as well and we'll talk more about that at the security analyst meeting.

In terms of seasonality from a revenue perspective, one of the big adjustments that you need to make on quarterly seasonality is the addition of the EDS to the portfolio so a number of you are running around with models that say the normal sequential increase in revenue from Q3 to Q4 is double digits, but when you layer in EDS, that significantly dampens that normal seasonality so it's more in the range of 8.5 points. When we put our guidance together, we basically looked at half two over half one and if you look at it on that basis, we have roughly normal seasonality half two over half one, we had a great start in Q3, we are of course as our usual selves prudent in Q4 and if we do better than functions that we've modeled we'll have upside in revenue and EPS in Q4.

**Scott Craig** - BofA Merrill Lynch - Analyst

Thank you.

**Operator**

Your next question comes from the line of Toni Sacconaghi of Sanford Bernstein. You may proceed.

**Toni Sacconaghi** - Sanford C. Bernstein & Co. - Analyst

Yes, thank you. I had two follow-up questions. I wanted to first push you on the share repurchase. You did \$2.6 billion this quarter. Your stock price is obviously considerably lower as you enter Q4, and your option overhang, it sounds like has not changed. Why wouldn't you be looking to materially step up your share repurchases, or invariably you're going to get more bang for your buck given the lower stock price so why wouldn't we expect a greater decline in share count and can you talk about how offshore or onshore cash may be a constraint in your ability to be more aggressive here and then I have a follow-up.

**Cathie Lesjak** - Hewlett-Packard - CFO, Interim CEO

Toni, let me address the second part of your question first. Whether offshore or onshore is not a constraint for us. The capacity that we have in the capital structure of our balance sheet is not a constraint at all. It doesn't matter where the cash is. We can either borrow or we have access to much of the cash offshore as it is so that's not a constraint. In terms of what we actually do in share repurchase this quarter, we'll announce it when we announce our fourth quarter earnings. We don't typically give guidance for what our share repurchase amount is going to be. We decided this quarter it was best to give you a modeling

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assumption to use about 30 million shares but obviously we were active in Q3. We liked the stock price in Q3. Q4 looks even more attractive.

**Toni Sacconaghi** - *Sanford C. Bernstein & Co. - Analyst*

Okay, and then I wanted to follow-up on the guidance. So you're guiding for about 6% sequential growth. I've done the EDS adjustment, still gets me to something that's about 9% for average seasonality over the last six or so quarters. Can you comment on what you expect currency to be sequentially and again, I think if we were to look at normal seasonality adjusted for EDS in the front half of the year, you were kind of in line and so the discrepancy seems pretty significant. Are you, do you have a discounted view of how strong consumer can be in the fourth quarter and is that part of the gap?

**Cathie Lesjak** - *Hewlett-Packard - CFO, Interim CEO*

First in terms of the currency that we're seeing from Q3 to Q4, because of the hedges that we have in place, there isn't much of a currency tail wind or headwind from Q3 to Q4 which might well be different than what you all are modeling because you don't have a full understanding obviously of the hedges that we have in place. That's the first thing and then in terms of the way we've thought about Q4 was we really looked at the seasonality of the half two over half one and we have a strong start to that half with Q3 and I don't think there's anything more to it than that.

**Jim Burns** - *Hewlett-Packard - VP IR*

Great, thank you. Can we take next question please?

**Operator**

Your next question comes from the line of Bill Fearnley of Janney Montgomery Scott. You may proceed.

**Bill Fearnley** - *Janney Montgomery Scott - Analyst*

Yes, thanks. If I could address the question of VJ in printing. It appears that the supply chain is fixed and so with the strong hardware performance this quarter, you still came in at the high end of the 15 to 17% range, so should we start, should we be thinking about IPG operating margins in the 16 to 18% range given that the strong hardware performance and then I have a quick follow-up.

**Cathie Lesjak** - *Hewlett-Packard - CFO, Interim CEO*

Let me address that. We don't let VJ talk about those things. Our guidance for this year is 15% to 17% and we're not really changing that at this point. We will talk more about what our guidance is for 2011 at our security analyst meeting. Our goal is to get as much growth as we can in the good usage hardware units and stay within our 15 to 17%.

**Bill Fearnley** - *Janney Montgomery Scott - Analyst*

And have you seen any effect of the expanded Canon relationship any benefit there in the most recent quarter?

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**Vyomesh Joshi** - Hewlett-Packard - EVP - Imaging & Printing Group

I think we have started with the copier lineup. We like the lineup that we got. We are selling managed print services, we had a very good quarter, sort of what total contract value for managed print services and I think the very important part is we want to continue to invest and innovate because innovation is our blood line so we want to make sure that not only do we place high usage unit but also we continue to innovate.

**Bill Fearnley** - Janney Montgomery Scott - Analyst

Thank you.

**Operator**

Your next question comes from the line of Mark Moskowitz of JPMorgan.

**Mark Moskowitz** - JPMorgan - Analyst

Yes, thank you, two quick questions here. One, Cathie, how should we think about the offsets in terms of PSG has driven a lot of the revenue upside for HP over the past year and a half, or so. Not all of it, but a good piece of it, and just with the softening on the consumer side, are there pieces in the pipeline whether it's IPG, you talked a little bit about services growth here forthcoming, that can help kind of bridge that gap if PSG does slide and then I have a follow-up.

**Cathie Lesjak** - Hewlett-Packard - CFO, Interim CEO

Really what we've seen and I'm sure you're aware, we've got both consumer and commercial solutions that drove our revenue in the third quarter to 11% growth. In the softer economy what we saw was a more resilient consumer and a commercial side of the business across the Company that put more of the brakes on spending and now what we're seeing kind of pick up faster is the commercial side of the business, so we've seen improved growth there, and good margins and we saw also strong performance if you go within the PC business in the consumer desktop and in commercial and workstations particularly, that obviously helped offset some of the growth changes on the consumer side.

**Mark Moskowitz** - JPMorgan - Analyst

Okay, and then I know the dust still has not settled as far as the CEO departure, but I want to get a sense in terms of recent days have you established some sort of delta force where you have maybe a tactical team that tries to go out and really provide account coverage for your platinum accounts because I know the prior CEO definitely had a very aggressive customer facing type of mantra in addition to cost cutting.

**Ann Livermore** - Hewlett-Packard - EVP, Enterprise Business

If you look at our customer coverage, as you would expect, we've got account general managers on all of our top accounts and we have sales rep coverage which we've been increasing month by month throughout the year, and so from a pure account coverage perspective, they aren't going to notice a delta. If you look at just one person, any one person, they solely are not going to be what drives the sales relationships or customer relationships. My staff and I, the whole Executive Committee have lots of customer relationships with our largest accounts, and we're making those calls and continuing to make those calls.

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You talk about our top accounts. I'll put another plug in for our networking business. Of our top 1000 customers, in the last 90 days, we've already had 300 of them sign up for these proof of concepts we're doing, so there's no wavering, there's no question, there's no issue with our top accounts.

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**Mark Moskowitz** - *JPMorgan - Analyst*

Thank you.

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**Jim Burns** - *Hewlett-Packard - VP IR*

We'll take the next question please?

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**Operator**

Your next question comes from the line of Abhey Lamba of ISI Group. You may proceed.

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**Abhey Lamba** - *ISI Group - Analyst*

Yes, thanks. On the industry standard segment, granted the growth rate was pretty strong on the year-over-year basis but the sequential growth rate for the low end of historical patterns. How should we think about the puts and takes given the demand in the corporate cycle was pretty strong?

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**Cathie Lesjak** - *Hewlett-Packard - CFO, Interim CEO*

So I'm struggling a little here because in fact our industry standard server growth was ahead of normal quarterly seasonality, so we continue to see good strength in industry standard server.

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**Abhey Lamba** - *ISI Group - Analyst*

Got you, I was looking at historical patterns, I think I might be looking at the wrong numbers. Lastly on the storage side given the acquisition of 3PAR, do you see any significant competitive shifts over there and as people kind of look at cloud computing do you think you have the full portfolio in that area? Thanks.

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**Ann Livermore** - *Hewlett-Packard - EVP, Enterprise Business*

We look at our storage business, we're executing against the strategy, you've seen us executing against and if we look particularly at this quarter we had an exceptionally strong quarter with our Scale-Out iSCSI products and that's the technology and product basis that we acquired with LeftHand so we had triple digit growth so it was a great quarter and customer reception there. We've also been very pleased with our IBRIX acquisition which gave us a file-based storage offering and then as well this quarter, we introduced our StoreOnce deduplication product as I mentioned earlier and the customer reception to this has just been fantastic, so we feel good about all of those things.

When you talk about applications and the Cloud movement and the things happening there, the other thing that we announced this week which is very pertinent for that space is our acquisition of Fortified Software and as customers are moving more and more applications to the cloud, they are even more intensely concerned about testing for the security associated with applications and so that's a move that we made in that space that's very aligned with moving applications to the cloud and the whole security related to it.

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**Abhey Lamba** - *ISI Group - Analyst*

Great.

**Jim Burns** - *Hewlett-Packard - VP IR*

Next question please?

**Operator**

Your next question comes from the line of Jeff Fidacaro of Susquehanna. You may proceed.

**Jeff Fidacaro** - *Susquehanna Financial Group - Analyst*

Great. Thanks for taking the question. Just on the supply side grew 5% in the quarter. Could you talk a little bit about how the inventory looks there? Was there any points contributed to a channel fill and I may have missed this but how is the fiscal fourth quarter shaping up, is that sort of a mid single digit type growth again?

**Vyomesh Joshi** - *Hewlett-Packard - EVP - Imaging & Printing Group*

I think the channel looks very satisfying as Cathie mentioned. We are focused on making sure that we put the right units in the place and get the right sell out. As far as the Q4 is concerned, we continue to look at the mid single digit range.

**Cathie Lesjak** - *Hewlett-Packard - CFO, Interim CEO*

And I think I should have said that we got the 8% constant currency growth without channel, the benefit of any channel fill, unlike some of our competition.

**Jeff Fidacaro** - *Susquehanna Financial Group - Analyst*

Great. Thank you.

**Operator**

Your next question comes from the line of Aaron Rakers of Stifel Nicolaus. You may proceed.

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

Yes, a couple questions. The first one, when I've heard you guys talk a couple times now about the enterprise pull through effect from your services business as you migrate into Phase II of the EDS relationship or acquisition. Is there any way, looking at the model, how we can look at that or is there any way of quantifying that pull through effect that we can really start to see that show up in the HP model over the coming quarters, and I do have a follow-up.

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**Ann Livermore** - *Hewlett-Packard - EVP, Enterprise Business*

So a couple of things associated with that. You heard both Cathie and I comment that our product pull through was up 50% year-over-year and we expect this increase to continue. You can think about it in two parts. As we solution new deals, we have an opportunity to build HP technology into those solutions, and then as customers get to upgrade points in the services contracts that we have with them, that's another opportunity for us to bring our technology into the solutions, so it's both those areas.

Another data point that we have is we know that in every client, when we look at the customers where we have a \$50 million services relationship or larger, our share of wallet with the rest of HP's portfolio is higher in those clients than in the rest of our customer base, so those are all good points. We'll have to think about how we can perhaps give you some view around how to model it but you should be confident that a big part of our strategy is going to be to use our services business to bring customers the best technology and in most cases we think that's HP.

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

And then the follow-up is, and I apologize if this was asked earlier but inventory build obviously looks like that was less about strategic purchases in the quarter for you guys, but did you give any commentary of what you're seeing component wise in terms of the pricing environment as we look into the next couple quarters?

**Cathie Lesjak** - *Hewlett-Packard - CFO, Interim CEO*

So on the component side, basically from Q2 to Q3, the component situation improved both availability and pricing became much more stable. We still obviously have an increase year on year. In terms of going into Q4, we expect it to stay kind of relatively stable, and obviously, expect the availability of supply to continue to be good enough.

**Jim Burns** - *Hewlett-Packard - VP IR*

Great. Why don't we take the next question and actually let's take one more question please, just last question.

**Operator**

Your next question comes from the line of Amit Daryanani of RBC Capital Markets. You may proceed.

**Amit Daryanani** - *RBC Capital Markets - Analyst*

Thanks a lot. Two questions. Just on the storage side if you look at your revenues up 10% over year, EVA was down, some of the pure storage vendors are seeing substantially better year-over-year revenue growth so my question is do you feel like you have all of the right assets in the storage marketplace given your desire to expand the total addressable market for HP?

**Ann Livermore** - *Hewlett-Packard - EVP, Enterprise Business*

If you look at a number of the newer assets that we have in our portfolio, they are still relatively small so from the overall impact to the growth rates they don't have as big an impact yet as they do with each successive quarter associated with it. You're going to see us and our storage business continue to be very focused on it and continue to invest in it. It's a critical part of our overall strategy to lead with converged infrastructure and having a strong storage portfolio as well as servers and networking and management software is all part of the strategy we're driving.

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**Amit Daryanani** - *RBC Capital Markets - Analyst*

You don't think you lacked the high end offering or scale offering that you need to for the entire product? It's a matter of growing what you have into more revenue numbers?

**Ann Livermore** - *Hewlett-Packard - EVP, Enterprise Business*

If you look at our XP offering we had a very strong business with our XP business this quarter so we were comfortable with those results.

**Cathie Lesjak** - *Hewlett-Packard - CFO, Interim CEO*

In fact we grew the XP business greater than 20% year on year this quarter.

**Amit Daryanani** - *RBC Capital Markets - Analyst*

Got it.

**Jim Burns** - *Hewlett-Packard - VP IR*

We actually are going to wrap up the questions and turn it over to Cathie.

**Cathie Lesjak** - *Hewlett-Packard - CFO, Interim CEO*

Before I go into my final closing comments, I did want to introduce Steve Fieler. Steve Fieler is our new VP of IR, who you will all hopefully meet in the next 30 to 60 days and I want to thank Jim Burns for a tremendously good job he did as the VP of IR, and by the way he slipped this piece of paper to me and said make sure you say this because he is really ready to go and support Ann as the Enterprise Business CFO. So thank you very much, Jim.

Just to conclude, we have and we are a very strong Company. Our broad based results in Q3 clearly demonstrate our ability to execute across many dimensions in this Company. We've got the right assets. We've got the right strategy and frankly the right people to execute the strategy.

We have unique and sustainable competitive advantages that provide us the platform that we need to drive profitable growth and these are the advantages, along with our ability to execute that have allowed us to raise our full year outlook for this year. We are aggressively moving forward and I'm confident in our ability to deliver results for our employees, our customers, and you, our shareholders, and with that, I just want to thank you for your time today, especially for those that had to stay late because of Dell announcing as well. Thank you.

**Operator**

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

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