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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the fourth quarter 2010 Hewlett-Packard earnings conference call. My name is Michael, and I will be your conference moderator for today's call.

(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. Steve Fieler, Vice President of Investor Relations. Please proceed.

Steve Fieler - *Hewlett-Packard - VP, IR*

Good afternoon. Welcome to our fourth quarter earnings conference call with Leo Apotheker, HP's CEO, and Cathie Lesjak, HP's Chief Financial Officer. Also joining us are Todd Bradley, Executive Vice President of Personal Systems Group, Ann Livermore, Executive Vice President of HP Enterprise Business, and Vyomesh Joshi, Executive Vice President of 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 and are subject to a number of risks and uncertainties and actual future results may vary materially. Please refer to the risks described in HP's SEC reports, including our most recent Form 10-Q.

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 2010 Form 10-K. 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 purchased intangibles, restructuring charges, and acquisition-related charges. Comparable GAAP financial information, and a reconciliation of non-GAAP amounts to GAAP, are included in the tables and in the slide presentation accompanying today's Earnings Release, both of which are available on HP's Investor Relations web page at www.HP.com. I'll now turn the call over to Leo.

Leo Apotheker - *Hewlett-Packard - CEO, President*

Welcome to our fourth quarter earnings call, and thank you for joining us today. Since the last time we spoke, I've been meeting with our customers and partners, as well as thousands of employees around the world. I joked on the day of the announcement that I might set a world record for travel, and I think I might have actually done it. I've been listening, I've been learning, and I've been immersing myself in the business. And today I'm even more excited and honored to be HP's CEO. HP is a Company with great momentum, incredibly committed and talented people, deep customer relationships and strong core businesses. I am confident in our future, and energized about the opportunity that lies ahead.

When I look at our Q4 results, what's clear is that HP is winning in the market, and we have an impressive ability to execute. I am proud of our leadership team and our people for their continued focus, during what has been extraordinary time for the Company. We finished our fiscal year with $126 billion in revenue. That's a 10% year-over-year increase, or an incremental $11.5 billion of growth. We grew nearly $1 billion per month last year. During the same time, we expanded our non-GAAP operating profit faster than revenue, up 14% year-over-year, and our non-GAAP EPS grew even faster, at 19% for the full-year. This is evidence of our strong operating leverage, our leadership positions, our ability to grow in higher margin categories, and our strong balance sheet.

We are carrying this momentum into FY 2011. We have the ability to drive continued growth, and at the same time I remain committed to driving operational efficiencies into the years ahead. I'm confident in our updated FY 2011 outlook, which Cathie will share with you in a moment. Before Cathie provides more financial detail, however, I would like to share some of my initial observations about HP, our potential, and also areas where we need to do things better. Now, bear in mind, these are just my initial thoughts. I've been on the job for just about three weeks now, and I still have good amount of listening and data gathering to do. I intend to provide a more robust perspective in the next few months.

For now, I will share three observations. One about customers, the second about our employees, and the third about our technology. I've received great feedback from our customers thus far. They are asking for a solution partner who helps address and solve their technology AND business challenges. They want access to information instantly, no matter where they are. And they want choice, not proprietary log-ins. The great majority are telling me that they want to do MORE business with HP. They like our openness, our price/performance, our industry-leading technologies, and our focus on manageability and security.

Look at ISS share gains and revenue, which was up 32% year-over-year. ProCurve Networking, another good example, was up 50% organically year-over-year. PSG continues to be the world-wide leaders in PCs. Our Enterprise customers want the ability to work in hybrid environments, both cloud and traditional, and this is HP's long-term opportunity and advantage. But I'm also hearing that we need to make it easier for customers to work with HP. We need to have the right coverage model that meets their needs. And we must be even more focused, on bringing our customers' products and solutions that deliver the promise of "Instant-On" across the consumer, SMB and Enterprise segments.

I have also enjoyed talking with our employees all over the world. They are very focused on our customers, and growing our business. They have terrific ideas, and also know how to drive operational efficiency. We welcomed new employees from 3PAR, ArcSight, Fortify and Stratavia in the fouth quarter. And I'm excited about these additions, and the integrations are starting off well. HP employees are a highly competitive group who want to win. They also want to be rewarded for their performance. This is consistent across the globe.

I believe in the performance-driven culture, and our employees HAVE been performing. Therefore, I'm pleased that we will be reinstituting salary increases in FY 2011, as part of our normal annual review process. It's well-deserved. Also, we are creating more sustainable, collaborative and productive work spaces for our employees. As part of this ongoing workplace initiative, we are revitalizing our global headquarters in Palo Alto. And we just completed the sale of our Cupertino campus, and we will be consolidating HP's Cupertino's site into Palo Alto over the next two years.

Now let me switch to technology. As Cathie described to you at the Securities Analyst Meeting in September, we have been increasing our investment in R&D. In the fourth quarter, R&D was up more than revenue growth, both year-over-year and sequentially. We should expect this trend to continue. We have a strong product portfolio with innovations across the Company. In the fourth quarter, we began shipping our Superdome 2, and our BCS business was up 10%. IPG achieved another strong quarter, including share gains in both laser and ink, and we continue to innovate around e-Print and web-connected printers. I'm very excited about the opportunity available to us to shape the cloud and mobile Instant-On platform

Moving forward, I'm excited to spend more time digging into our technology. We have so much opportunity, unique opportunity, as a Company. And it is not simply about spending more on R&D. Rather it's about driving more leverage from our existing portfolio and resources to create HP solutions. It is about adding more agility to our scale, and accelerating our innovation cycles. We are in a unique position to drive better, more consistent, and unified user experiences across our portfolio, like with our converge infrastructure offerings. And we can leverage even more technologies, to create and sell integrated value-added solutions, in addition to our point products.

Just as we help our customers knock down their technology silos, we have the opportunity to knock down a few of our own. HP has already been moving in this direction, but we can do more. We need to enhance our software IP across the Company, to create more differentiation with our products. This includes strengthening our core software business segment, as well as adding value-added IP and services that cut across all segments. As an example, HP has the leading software and unique IP called MetaVance and interChange, to administer health plans and process claims for healthcare organizations. This is an HP platform that leverages software IP infrastructure, along with value-added services to provide the fully integrated vertical solution.

Today, HP processes over a billion claims in the US annually, or about one in every four claims. HP now runs Medicaid in 22 states. We're improving quality of care, and reducing operational costs for our healthcare customers, and ultimately solving both their technology and business challenges together. In the next weeks and months ahead, I will continue engaging with our customers, partners, employees, senior leaders and investors. While I still have more listening to do, a few things are already very evident to me. HP is a strong Company. We have a significant opportunity in front of us. And we will continue to lead the marketplace, and create value for our customers and shareholders. I'll now hand the call over to Cathie.

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

Thanks, Leo. Hewlett-Packard delivered strong, balanced growth in the fourth quarter across all regions and market segments. In Q4, we added $2.5 billion of new revenue, expanded gross margins and operating margins, and grew earnings per share by 17% year-on-year. We continue to execute our strategy, moving up the stack, and increasing our mix of higher margin businesses to drive sustainable gross margin improvements. In Q4, we saw strong growth in margin accretive solutions such as Virtual Connect and BladeSystem Matrix, as well as the contribution from strategic acquisitions such as 3Com. These benefits, combined with disciplined pricing and promotion activity, drove gross margin expansion of 110 basis points versus the prior year to 24.8%.

We are investing for growth and augmenting our global sales force to improve the coverage of our $1.6 trillion addressable market. Our solution portfolio and technology offerings are strong, and we are encouraged by the initial results of our Enterprise sales force deployment. Looking into the details of the quarter, revenue for the fourth quarter totaled $33.3 billion, up 8% from the prior year or 9% adjusting for currency. We continued to see momentum in the commercial sector, led by strength in converged infrastructure, managed print services, and commercial printers and PCs. We posted solid double-digit revenue growth across our hardware businesses, with Enterprise Storage and Servers growing 25%, and ProCurve Networking up 50%. Commercial printer hardware and PSG commercial revenue grew 22% and 20%, respectively. Additionally, in Services our book-to-bill ratio for the trailing 12 months remains comfortably greater than one.

Looking at revenue by geography, we had balanced performance with revenue in the Americas and EMEA increasing 10% and 6%, respectively. In Asia Pacific, revenue grew 8% with strong growth across the region, partially offset by some ongoing HP challenges in the China PC business. Excluding China, Asia Pacific achieved double-digit revenue growth.

Turning to the expense side. operating expenses increased to $4.2 billion, as we accelerated investments to drive long-term growth, including increases in R&D and expansion of our sales force. We are strengthening R&D, both through incremental investments, and the addition of strong technical talent from the acquisitions that we made in fiscal 2010.

Non-GAAP operating income increased 10% year-on-year to $4 billion, as gross margin expansion more than offset the incremental investment in sales and R&D. Fourth quarter non-GAAP net income improved to $3.1 billion, and non-GAAP diluted earnings per share increased 17% to $1.33. Looking at the full-year, we delivered revenue of $126 billion, non-GAAP operating income of $14.4 billion or 11.4% of revenue, and grew non-GAAP earnings per share by 19% to $4.58. As Leo mentioned, HP is focused on creating value for our customers. In the Enterprise business, this means driving our vision by delivering converged infrastructure, modernizing applications, securing the Enterprise, and managing information. This quarter demonstrates another proof point that HP is winning.

The Enterprise Storage and Server business produced record revenue of $5.3 billion in the quarter, up 25% year-over-year, with balanced double-digit growth across each business unit and every region. Operating profit for the business was up 52% on a year-over-year basis to $730 million, with operating margin of 13.9%, an increase of 250 basis points from the prior year, demonstrating the operating leverage in the model. Our Industry Standard Server business achieved the number one market share position in all three regions, with growth of 32%, and ESS Blades far outpaced the market with 51% growth year-over-year. Within the Business Critical Systems group, we successfully launched the Integrity Superdome 2, as the flagship solution of the mission-critical converged infrastructure. Superdome 2 delivers best-in-class system level performance and scalability, while improving resiliency more than four times over the original Superdome. Business critical systems revenue grew 10% year-over-year, with strong growth in the telecom sector in the Americas, and more balanced growth across verticals in other regions. In Storage, revenue increased 14% from the prior year, with balanced growth across our broad portfolio. We are investing in the most attractive high growth segments, and our strategy is working. In Q4, we delivered triple digit growth in our scale-out iSCSI products, our Enterprise NAS, and our StoreOnce data deduplication technology. We are also very pleased with the traction and buzz around the 3PAR acquisition, which closed on September 27. We are already seeing accelerating interest in these products from our existing and new customers, and expect to expand 3PAR's routes to market by leveraging HP's broad channels and Enterprise sales force.

HP Networking, which is reported in Corporate Investments, continues to build on its world-wide momentum, while executing ahead of plan. Revenue in HP networking grew 227%, with ProCurve revenue up 50%. Our TippingPointsecurity portfolio also delivered strong growth. In the Americas region, historically one of the most competitive markets, HP ProCurve revenue more than doubled. We see strong demand for our networking solutions, as our value proposition of better performance, improved security, single pane-of-glass manageability, and lower cost of ownership is resonating with our customers. Enterprise customers continue to demonstrate interest in our networking product portfolio, with over 400 of HP's top global accounts enrolling in the HP Networking proof-of-concept program, since we closed 3Com in April. We had a good quarter in state and local government accounts, as well as new wins with the BMW Group and Underwriters Laboratories. Services delivered revenue of $9 billion, up slightly from the prior year. Infrastructure Technology Outsourcing, Applications Services, and Technology Services revenue each grew roughly 1%. Outsourcing saw strength in the US public sector, with renewals and new Medicaid business. Business Process Outsourcing revenue was down 11%, including a 7% negative impact due to the divestiture of ExcellerateHRO.

Our pipeline of Enterprise services opportunities remains robust, and we are actively investing in the field, to build out our addressable market coverage. We continue to see healthy HP product pull-through in our enterprise service accounts, and we expect this trend to continue. Services segment operating profit in the quarter increased to $1.5 billion or 16.7% of revenue, up 50 basis points from the prior year, driven by improvements in service delivery. For the full-year, Services delivered $5.6 billion in operating profit, and expanded operating margins by 160 basis points, even as we continued to invest in sales coverage, transformation, and on-boarding new deals.

HP Software revenue was $974 million, up 1% compared with the prior year. Business Technology Optimization revenue increased 4%, and Other Software revenue declined 6%. We are excited about expanding our security presence with a recent acquisition of Fortify and ArcSight in the quarter. The software business expanded it's operating margins by 120 basis points year-over-year. Operating profit was $247 million, or 25.4% of revenue, up from $234 million or 24.2% of revenue the prior year period.

Turning to Personal Systems, PSG revenue increased 4% from the prior year to $10.3 billion, with total unit shipments growing 2%. Segment operating profit totaled $568 million or 5.5% of revenue, up 80 basis points year-over-year, as PSG benefited from favorable component pricing, and disciplined pricing and promotion programs. The commercial refresh continues. In SMB, we are launching new call centers internationally, building on the success we have seen with the call centers in the US. We maintained our market leadership position in commercial PCs, and once again expanded our share in the US enterprise segment by winning new accounts from competitors, and investing in channel programs. As a result, Commercial Client revenue grew 20%. Workstations had another strong quarter with 55% growth, and Commercial Desktop revenue was up 23% year-over-year.

Total Notebook revenue was down 3%, reflecting softness in Consumer notebooks. The consumer weakness was predominantly in low end notebooks, and largely impacted by our performance in China. The issues in China are well within HP's control, and we are addressing them. Our current focus is on rebuilding our brand and channel relationship, so that HP can regain the share lost as a result of latent quality issues this past spring. We spoke to you at our September Analyst meeting about our PC efforts in Brazil, and I am pleased to report that HP has taken the number one revenue share position in Brazil.

Moving on to Palm, which is reported in Corporate Investments. We continue to invest in the Palm assets, including the webOS in a variety of connected mobile devices. This quarter, we released webOS 2.0, and introduced the Palm Pre 2 SmartPhone.

Imaging and Printing had a strong quarter. Revenue grew 8% to $7 billion, fueled by year-over-year hardware revenue growth of 16%, and supplies revenue growth of 6%. Segment operating profit totaled $1.2 billion, or 17.4% of revenue. Total printer unit shipments increased 14%, and we gained market share across all printing categories, with particular strength in higher-usage segments.

Commercial printer units increased 43%, with multi-function printer units up 83%. Business ink and wireless printer units were up 22% and 53%, respectively. In addition, we shipped almost two million web-connected printers in the quarter. We continue to innovate across our portfolio. In September, we announced cloud print for businesses, using HP Print Apps, as well as new software capabilities for enterprise printing. In our hardware portfolio, we introduced new products in our Inkjet, LaserJet and Designjet categories. Finally, we are delivering on our growth initiatives in retail publishing and managed print services. During fiscal 2010, we more than doubled our retail publishing install base, and delivered very significant growth in managed print services signings.

HP Financial Services continues to deliver strong consistent results. In the fourth quarter, financing revenue grew 11% to $809 million. Financing volume increased 11%, and net portfolio assets increased 14%. Operating profit of $73 million, compares to $66 million in the prior year period. Return on equity for the fiscal year was 15%.

Now on to the balance sheet and cash flow. Our balance sheet remains strong. We closed the quarter with total gross cash of $11 billion. Our fourth quarter cash conversion cycle was 21 days, up seven days from a year ago, with days sales outstanding up two days, inventories flat, and days payable down five days. Channel inventories in each business are in good shape. PSG channel inventory is down from the prior quarter, in line with our expectations. We generated operating cash flow of $3.2 billion, and free cash flow of $2.2 billion.

During the fourth quarter, we returned $4 billion to shareholders through share repurchases, and reduced our weighted average shares outstanding by 79 million shares sequentially. At the end of the quarter, we had roughly $10.9 billion remaining in our current share repurchase authorization. Finally, we paid dividends, totaling $181 million. For the full-year, we generated $11.9 billion in operating cash flow, $8.4 billion in free cash flow, and returned $11 billion to shareholders through share repurchases and dividends. Before I discuss the outlook, I want to remind you that we expect to pay a cash bonus based on our fiscal 2010 performance, which will impact Q1 cash flow.

And now, a few comments on our outlook for the first quarter and full-year fiscal 2011. We expect Q1 fiscal 2011 revenue to be $32.8 billion to $33 billion. For the full year, we now expect revenue of $132 billion to $133.5 billion. Regarding earnings, there are a few variables to keep in mind. First, we will continue to fund investments to drive long-term growth. And second, we expect OI&E expense of about $0.05 per share, as a result of increased debt, and normalized foreign exchange currency losses. We expect a tax rate of 22%, and a more modest decline in weighted average shares outstanding than we had from Q3 to Q4, and for the full-year, we now expect weighted average diluted share count to be approximately 2.25 billion shares. Thus on an operational basis, we expect first quarter earnings per share to be in the range of $1.24 to $1.26.

In addition, in Q1 we expect to realize a one-time gain of approximately $0.04 per share, primarily related to the disposition of real estate. As a result, including this one-time $0.04 gain, we expect total first quarter EPS to be $1.28 to $1.30. For the full-year, we are raising our earnings outlook, and now expect non-GAAP EPS of $5.16 to $5.26, including the one-time $0.04 gain, representing growth of approximately 13% to 15% for the fiscal year.

In summary, we feel good about our broad-based performance in Q4. And for the year, we achieved double-digit growth in revenue, gross profit, operating profit, and earnings per share, as well as demonstrated the operating leverage in the model. As a Company, we are executing on the plans we have laid out, and delivering on our commitments to customers, partners, employees and investors. We are effectively balancing our growth, investments, and efficiency initiatives. 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.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions).

And your first question comes from the line of Richard Gardner of Citigroup. You may proceed.

Richard Gardner - *Citigroup - Analyst*

Thank you very much. One for Leo, and one for Cathie, if I could. Leo, first of all, you mentioned in your initial discussion the need to enhance HP's software IP position. And I was just wondering if you had any initial thoughts on whether that could be accomplished organically, or through a string of pearls or smaller acquisitions, or whether HP needs to think about something more transformative there?

Leo Apotheker - *Hewlett-Packard - CEO, President*

Well, it's a very interesting question. It's a bit early for me to give you a precise answer. What I can say at this moment in time, is that we want to strengthen our software capabilities, both as a business, and also as a cross-HP capability to add more value to the various activities that we undertake. We have many options available to us. And we can do some of it organically, some of it non-organically, and you'll easily understand that we won't comment on any M&A activity during this call.

Richard Gardner - *Citigroup - Analyst*

Okay. Thanks. Thank you very much. And then Cathie, I was hoping you could comment on channel inventories especially on supplies, where it sounds like there were some price increases in Europe at the beginning of the quarter. I know typically you give channel partners advance notice of those types of price increases, and was wondering if there was any inventory increase in supplies as a result of that? Thank you.

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

Thanks, Rich. It must be Thanksgiving, since we're giving you an opportunity to ask a second question. But in terms of channel inventories, we actually exited Q4 with channel inventories in really good shape. And so there are no concerns from our perspective, on the channel inventory position.

Steve Fieler - *Hewlett-Packard - VP, IR*

Thanks, Rich, we'll move to the next question.

Operator

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

Benjamin Reitzes - *Barclays Capital - Analyst*

Yes. Thanks a lot. I wanted to ask Leo and the team about the environment, and what they're seeing -- what you're seeing in general. If you take your guidance, lower share count could arguably account for more than half of the raise for the year, and obviously if you put some of the sequential. So it looks conservative on the revenue guidance for the first quarter. I was wondering if you view this guidance as conservative, and if you could talk a little bit more about what you're seeing in the market place, perhaps from the economic side, particularly in Europe?

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

So Ben, why don't I start with macro first, since I think that's kind of underlying a lot of your number of questions, in that one. And basically from a macro perspective, what we saw was good, balanced performance across our regions. On a constant currency basis, we saw Americas grow 9.5%, EMEA was up 11%, and excluding Japan, APJ grew double-digits year-on-year. We also saw accelerated growth in emerging markets, including Brazil, Russia, and India. And so that's kind of the macro environment that we saw.

And then in terms of kind of our guidance for revenue, and I'll talk specifically about Q1. I think it's important to note, A, for the year that we raised the midpoint of our revenue guidance, and that the guidance now in Q1 shows revenue growth of 5% to 6% year-on-year. And you know us, we tend to be prudent. And this quarter, I think there are two good reasons for that. The first one is that, we did see in Q4, uneven consumer performance across our geographies and our product categories. So that's one element of prudence. And the other element is just that, we're calling for a more modest increase in revenue in industry standard servers, since we had seen significantly better than kind of normal seasonal growth in industry standard servers for the past few quarters. And so that kind of leads us to obviously the guidance that we provided for Q1 revenue.

Steve Fieler - *Hewlett-Packard - VP, IR*

Can we move on to the next question, please?

Operator

(Operator Instructions).

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

Keith Bachman - *BMO Capital Markets - Analyst*

Yes. Thank you very much. I wanted to see, Cathie, if you could talk a little about the context of your FY 2011 guidance, and specifically you mentioned a number of times in your prepared remarks, that you're increasing R&D. And so as we think about it, should we assume that the gross margins stay at, or even go up from these levels as you increase OpEx? Or if you could just add a little color, how we should be thinking about the FY tensions between growing OpEx, versus meeting the expectations that you just laid out?

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

Yes, so we talked a lot at the Security Analyst meeting about the fact that our revenue mix, and the growth that we see is, in kind of more margin accretive category. And if you add in that, the acquisitions that we've done as well, we do think that there is good upward pressure on gross margins. And of course, you then want to look seasonally at what normally would happen from Q4 to Q1. And then note that in Q1, it's typically our lowest gross margin quarter in the year.

Steve Fieler - *Hewlett-Packard - VP, IR*

Okay. Next question, please.

Operator

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

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

Yes. Thank you. I know you talked about R&D expense increasing, and the rationale behind it, but your SG&A expense was up almost 17%. And I think it was the first time in more than seven years, OpEx actually grew faster than revenue. Are you front-loading OpEx at all? Because my observation is, yes, you spent more on OpEx, and you've got higher gross margins. But if you look at operating margin year-over-year, your improvement in Q4 was actually the lowest it was, in any quarter in 2010. So if the notion is, we're going to invest to get higher gross margins, and ultimately that will translate into better operating margins, we actually didn't really see it this quarter. And so -- sorry for the long-winded backdrop -- I guess the question is, how do we think about OpEx growth relative to revenue growth, and was there any front-loading this quarter? And if not, how do we rationalize that ostensible tradeoff you're making?

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

Tony, I'm not quite sure I know what you mean by front-loading. But at the Security Analyst meeting, what we said was that both R&D and sales expense would grow faster than revenue. And that happened this quarter. And we expect to have that be the case for all of fiscal 2011. And it is basically being funded by expanding gross margins in our business. We talked about where the growth is happening, and the acquisitions that we have made, that are in more margin accretive categories.

Leo Apotheker - *Hewlett-Packard - CEO, President*

Let me maybe add a couple of comments to what Cathie has said. And let me be very clear about this. First of all, there's always an opportunity to drive increased productivity, in particular, relative to our scale. And you can rest assured, that we will never stop driving more efficiencies, and there are some very strong programs in place to make that happen, be it supply chain, or in our services business. And we are all committed, and I am in particular committed to continue our focus on operational efficiencies. However, you need to invest to create sustainable operating leverage. And you need to do this on a continuing basis as well. And we will use some of the savings that we generate from our efficiency initiatives, to continue investing in more R&D and into more sales. And we are also investing a little bit into our own people. All of this, in order to ensure that we have a strong business going forward.

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

And actually, I need to correct something that I said. I apologize. I misspoke. When I talked about the macro environment, and I talked about APJ growing double digits in constant currency, I inadvertently said excluding Japan, when in fact it was excluding China, is what I intended to say, and I apologize.

Steve Fieler - *Hewlett-Packard - VP, IR*

Okay. We will take the next question, please.

Operator

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

Scott Craig - *BofA MerrillLynch - Analyst*

Yes. Thanks, good afternoon. Cathie, just going back to the operating expenses, here for a second. You noted in your commentary that there's going to be a cash bonus impact next quarter. Is it possible to give us a rough quantification of that? It seems somewhat one-time in nature so-to-speak, even though hopefully it will happen every year for you guys, but just wondering how much of an impact it's having next quarter? Thanks.

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

This is not -- it has not been one-time in nature. I think we have paid, kind of a comparable bonus each of the last -- I want to say four years. But it's remotely possible, it was only three. But it's not materially different than what we've been seeing.

Steve Fieler - *Hewlett-Packard - VP, IR*

Next question.

Operator

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

Katy Huberty - *Morgan Stanley - Analyst*

Thanks. Good afternoon. Cathie, you talked about the reasons for perhaps conservative revenue guidance in the first quarter, which is more or less in line with consensus. In that context, as well as some comments from peers around the public sector, can you talk about what gave you the confidence to raise the full-year 2011 revenue forecast versus the more conservative view next quarter?

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

Yes. So we actually basically raised the midpoint of the fiscal 2011 guidance, by basically -- compressing the range a bit. And the confidence that we have, is that we are performing very well. And you saw it in Q4. And that gives us the confidence that we can make the range that we gave at the Security Analysts meeting by truncating off the bottom end.

Operator

Your next question comes from the line of Brian Alexander of Raymond James. You may proceed.

Brian Alexander - *Raymond James & Associates - Analyst*

Yes, could you just comment a little bit more on the networking business, obviously it's a big opportunity for you guys. To what extent have you begun using the pricing lever a little more to gain share? I think you previously said, Cathie, that 3Com's operating margins have drifted higher since you acquired them. But at point do you accelerate the share gains via pricing, given the flexibility you have in the model? Thanks.

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

Well, I also -- I think I also mentioned at that conference, that not only had 3Com's margins shifted higher, but so had ProCurve, and that continues to be the case. And I'll let Ann kind of comment more on the networking business.

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

Yes, in fact, we see networking as a great opportunity to simultaneously grow revenue, expand margins, and also capture share. And if you look at the last two quarters, we've been doing all three at once. In fact, to your point about the pricing, we've seen both revenue and margin be ahead of plan. And what we're seeing with 3Com, is as Cathie said, we're certainly pleased with the integration. And for the first two quarters that it has been part of HP, the revenue for 3Com has been ahead of plan as well.

We look broadly at our networking capability, and Virtual Connect was up 50%, and ProCurve was up 50% too. And what we're really seeing is, we've just got a value proposition that's very attractive to customers. This is a marketplace, where over the last few years, the marketplace was characterized by high prices, proprietary technologies, and just flat-out not enough competition. And what HP's been able to bring to the market is something that customers just flat-out really like.

They like the fact that it's a new, open architecture. They like the fact that we're using industry standards. They like the fact that we have a single management console, which makes the cost of operations lower. They like the fact that our products have better energy efficiency. And on top of all that, we can price and still make great margins, at a significantly better value for them. So we're just very pleased with the market acceptance, and reaction that we're seeing.

Operator

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

Aaron Rakers - *Stifel Nicolaus - Analyst*

Yes, thanks. Question goes back to the gross margin line. I think on average, over the past few years, I think your sequential change in your gross margin going into the January quarter has been down about 30 to 40 basis points sequentially. Given the guidance you've given, is there anything that in the model that changes that historical type of sequential trend? And then on top of that, can you help us bridge, what was driving the gross margin between mix shift this last quarter, versus obviously a more favorable component pricing environment? Thank you.

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

I'll take the last question first. Basically, the 110 basis point expansion in gross margin was from strength in networking, as well as in the Enterprise Server and Storage, so that's kind of the mix elements there. And then from a rate perspective, the commodity pricing environment clearly benefited PSG. And then we had good service delivery efficiencies on the Services side. And combined, that's really what drove the 110 basis points improvement in gross margins. And I would say in terms of, the sequential kind of impact on gross margins, that we would be looking at kind of typical normal seasonality in -- from Q4 to Q1. And so I wouldn't model anything significantly differently than that.

Operator

Your next question comes from the line of Maynard Um of UBS. You may proceed.

Maynard Um - *UBS - Analyst*

Hi. Thanks. Leo, can you talk about your comment about customers wanting choice, and not vendor lock-in? And obviously, some of your competitors are driving vertically integrated stack solutions, and certainly HP has a lot of those pieces within the stack, and can kind of offer this one stop shopping for customers. So can you just maybe expand on your comments there, because in your comments that you want to own more of the software IP and assets, presumably you can pull along more hardware sales, and make it more like a vertically integrated stack. But it sounds like that's not necessarily what your customers want. Can you just help us understand the nuances there, and what the plans are on expanding your software IP? Is that a function of R&D as well? Thanks.

Leo Apotheker - *Hewlett-Packard - CEO, President*

Well, that's a number of questions rolled into one. Let me try to give you a bit of a summary answer. You're right, in your analyzers. What you have to recognize is that customers have different needs at different points in their evolution. There's a very exciting thing happening out there, which is a trend towards cloud. And customers want to get into the cloud, depending on where they're coming from, either in one shop or gradual steps. They even want to use public cloud, or private clouds, or they even want to stay in a hybrid environment.

We have varied our position to serve all of these demands from the markets, at different price points and with various technologies. Customers don't want to be locked into a particular type of a standard. So we have been trying over many years, to provide customers with open systems and industry standards. And the success that you can see in our converged infrastructure is driven among others, because it provides openness to our customers. That doesn't mean that we cannot provide integrated solutions, that contain both of some of our own IP software, because we believe that bundling it together and providing it as a solution, and not as distinct and discrete products, will give customers a higher value set. And there are many examples that you could share, and I will ask Ann to give you one or two of them, so that you get a better idea of what I'm trying to talk about. Ann?

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

Yes. As Leo was just saying, our strategy is quite different than some of our competitors, because our strategy is actually to give customers choice. When you look at the integrated appliances that are on the market today, that's just one segment of the overall server market. And what you'll see is that HP actually offers these integrated appliances, but we offer it with lots of different vendors. We offer these appliances with SAP, with Microsoft, with Oracle. And you'll see us offer these integrated tuned appliances with lots of different software vendors. And our view on this, is that when you're like HP, and you've got the number one market share in X86 servers, and we have a 38% unit share, and then you've got the power of the converged infrastructure solutions we have, across networking and storage and servers and power and cooling, then what you can do is you can help a customer transform their datacenter. And at the same time, doing that without locking them into one proprietary stack. So we're pleased with the positioning that we have here in the market.

Operator

Your next question comes from the line of Jayson Noland of Robert Baird. You may proceed.

Jayson Noland - *Robert W. Baird & Company, Inc. - Analyst*

Thank you. A question on consumer. I believe consumer represents about 25% of revenue, give or take. And I guess what's driving the weakness? Is it macro or something else? And what are your assumptions for consumer baked into F 2011 guidance? Thank you.

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

So let me just start by confirming that consumer revenue does represent roughly 25% of our total revenue. And obviously, we've got a pretty diverse portfolio, which serves us well, when there are market shifts. We don't get impacted by quite as much as other companies that are more concentrated. In Q4, we did see uneven consumer performance across our geographies and our product segments. And I think maybe I'll ask Todd to briefly talk about the PC.

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

Yes. Thanks, Cathie. I think the first point is our portfolio, our PC portfolio is diversified across multiple consumer and commercial solutions. And as the global economy slowly recovers, consumer's PC purchases have remained somewhat soft, while business demand shows growing strength. And I think more companies than ever, are refreshing out of their older technologies. In the quarter, we saw very uneven consumer PC performance across our geographies. We saw EMEA with somewhat modest growth on a constant currency basis. In the US, consumers are somewhat cautious about spending, and are increasingly deal-driven. And the challenges in Asia-Pacific were really localized to China, which we're fixing.

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

In the China space specifically, we're really focused on rebuilding our brand and our channel, as well as obviously, our position in the China market. It's going to take us a few quarters, but we did see sequential share growth in China for PSG's business in calendar Q3. And as Todd mentioned, our desktop and workstation businesses remained strong. So we're confident, that we're on the right path.

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

And I think as we look at the holiday, we're very well-positioned in the marketplace. We have an array of products across a range of price points, and we'll participate in Black Friday with products across our product line and price point line.

Steve Fieler - *Hewlett-Packard - VP, IR*

Next question, please.

Operator

Your next question comes from the line of Brian Marshall of Gleacher & Company. You may proceed.

Brian Marshall - *Gleacher & Company - Analyst*

Great. Thank you. Question for Todd and Ann. If you look at some of the product lines on an individual basis, were up obviously 50% plus, Blade's up 51%, and ProCurve up 50%. By and large, are these products being sold on an individual basis, or is this more of a kind of overall systems approach or solutions approach if you will, converged infrastructure theme, Blade system matrix, et cetera? Thanks.

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

If you look at it specifically from the server side, what we see is actually both. We see some instances, where we have clients who just want to do server refresh. And they can get a great ROI by upgrading to a G6 or a G7. And the return is just so fast, that you'll see just pure upgrades. At the same time, we're doing a lot of work around converged infrastructure. where we're doing whole modernization of datacenters. And in those cases, what you see us doing is putting together a solution that might be a combination of servers, storage, networking, power and cooling, management software, security software, and services associated with it to build out the datacenter. So just a complete solution.

And then we have other instances, where we have customers who want to get started with a private cloud. And what we've got is the service we call cloud start. And in cloud start, what we can do is take our services capability, put together a design for a customer on a private cloud, and using our Blade system matrix software, along with our services software, and our management software, actually get them up and running with a private cloud in 30 days. And just as one example, we had a bank in the US that we provided this sort of project for. And what they saw was, it used to take them months to be able to deploy additional server capacity. And now they can do it in two to three hours, so incredible advantages in terms of flexibility and cost. So we're actually seeing this growth come in lots of different flavors, in terms of the transactions and broader solution projects.

Steve Fieler - *Hewlett-Packard - VP, IR*

Next question, please.

Operator

Your next question comes from the line of Bill Fearnley of Janney Capital Markets. You may proceed.

William Fearnley - *Janney Montgomery Scott - Analyst*

Thanks. A question either for Cathie or VJ. How should we be thinking about the balance between IPG operating margins and unit growth? I mean operating margin was above 17% in a strong hardware quarter. Is 17 to 17.5 plus the new operating margin target, or do you see having to invest more in sales staff, promotions, things like ePrint, R&D to help keep units strong?

Vyomesh Joshi - *Hewlett-Packard - EVP, Imaging and Printing Group*

Well, I think IPG had a strong quarter. And we want to continue to invest into unit growth and innovation, because that's really the driving force for IPG continuing to grow revenue. If you look at the unit growth, we want to continue to drive units in 2011. As a matter of fact, we would like to put at least 20% unit growth for LaserJet in Q1. As far as the innovation is concerned, the ePrint, we are getting very good reception. As I mentioned in the -- our Analyst call, 2 million units in Q4, and 5 million units in calendar 2010. We absolutely believe that our innovation that we are driving will help us to drive more supplies growth, and really establish IPG globally.

Steve Fieler - *Hewlett-Packard - VP, IR*

So we have time for two more questions.

Operator

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

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

Yes. Thank you. Good afternoon. The question's for the floor. I just had a question, as far as the services growth trajectory here. Did the 4Q performance, was that kind of in line with what you expected when you kind of tempered the FY 2011 forecast related to services growth? And how should we think about that getting jump started? Is it going to be inorganic or organic growth from here?

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

You should think of our services growth as primarily organic growth. And as you've heard us say over the last few quarters, we've been very pleased with the signings. And Cathie also made the comment that our trailing 12 months book-to-bill is comfortably above one. So those are all things that we feel good about. We also feel very good about the quality of the pipeline, as well as the size of the pipeline, when we look at the deals that are in the funnel. We also have inside the services business, as Leo mentioned at the very beginning, some new innovative services that are in the application space, and also some of our industry solutions. On top of that, we're continuing to make investments in sales coverage, specifically around growing our services business. And that includes sales investments, in terms of our basic support services sold along with products. So we feel great about all these things. And these are all things that as you know build over time, and so that's why we've given the guidance that we have.

One more thing about the services growth, is it's also important to us in terms of our ability to pull together and integrate solutions. And then also on top of that, the product pull-through, we've seen our product pull-through increase 50% year-over-year. And that includes pulling through servers, storage, networking, software, printers and PCs. And since we closed the acquisition of EDS, as new deals are solutioned, we have a higher percentage of the content that is solutioned with HP. So that's not specifically services growth, but it's another valuable aspect of services helping our overall portfolio growth.

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

And Mark, let me also add that we kind of view our services growth, as being roughly in line with the market. And that with the continued cost structure improvements that we're making, as well as the investments that Ann talked about in sales coverage, and the new innovative service offerings, that we would expect to grow at or above the market in the long term.

Steve Fieler - *Hewlett-Packard - VP, IR*

Okay. Last question, operator.

Operator

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

Shannon Cross - *Cross Research - Analyst*

Hi. Leo, I had had a question for you. Could you just talk a little bit more on your initial thoughts on what you're seeing at HP, sort of on a segment basis, and how HP's fitting in vis-a-vis the competition, how you think they're positioned vis-a-vis cloud, just if you could sort of talk maybe segment by segment what you've seen so far, granted it's only been three weeks, but sort of how you see the Company positioned, and then how you expect the next year or so to go? Thank you.

Leo Apotheker - *Hewlett-Packard - CEO, President*

Okay. That's a long question. I'll try to give you a reasonably short answer. HP has many strengths, and it's actually a formidable Company. To name just a few of these strengths, I'd like to say the breadth of our technology portfolio, our scale, our people, our customer relationships, and our operational excellence. I do believe that our greatest strength is actually our opportunities. Given our size and breadth, we have a unique position in the market to expand, to do way more business in emerging markets, to become more of a solution provider for our customers, and to leverage our own technology better across the entire Company.. And you should bear in mind, that our technology trends are morphing, and they are morphing rapidly.

We, at HP, have the opportunity to grow our leadership position. We're addressing the cloud in many ways, an example, converged infrastructure, and we are addressing mobility with webOS. So all of these are fantastic opportunities that we are looking at. Our opportunities are also to integrate more of our IP together, because ultimately customers don't actually want to buy hardware, software or services or whatever else. They want us to help them solve their problems in the most flexible, secure, and cost effective way, and will use our integrated hardware, software and services to do just that. Customers are also not looking just for cloud, in exactly the same way as we discussed early on. And we'll continue to deliver solutions in the hybrid environment, whether it's on-premise, through the cloud, or hosted.

But what customers really want, is a partner who can help them to be more productive, meeting their demands instantaneously, in 24 by 7 connected world. And that that's why we announced our Instant-On solution phase, which addresses exactly that particular need. So to give you the short of it all, and the net of it all, I believe we are extremely well positioned across all of our technologies. And we have if you want, a secret formula, a secret sauce, that we can actually put to bear to our advantage.

We are the only Company in this industry that is equally good on the Consumer side, and on the Enterprise side. And if we manage, and we will work very hard to do that, to leverage the rapid innovation cycle that occurs on the Consumer side, basically the Enterprise, make it (inaudible) more scalable, and then use that to our benefit, I think that will give us an immense competitive advantage, which is one of the reasons why we need to spend a little bit more money on R&D, and one of the reasons why we need to invest into our sales force, so we can bring all of this to bear, in a very effective way to the market. So net-net, I'm very optimistic.

And maybe if we are closing this call, a few remarks just to close this call up. We are winning in the market, and we have a significant opportunity in front of us. We had a very strong Q4, and I am confident that we'll execute in Q1, and the years ahead. I'll continue to be focused on our customers, partners and employees. And I look forward to meeting with investors in the coming months. And for now, thank you for your time today, and have a great day. Thank you.

Operator

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