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PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the first quarter 2011 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. Steve Fieler, Vice President of Investor Relations. Please proceed.

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

Good afternoon. Welcome to our first quarter earnings conference call with Leo Apotheker, HP's CEO, and Cathie Lesjak, HP's CFO. 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-K. 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 Q1 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. 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 Investor Relations web page at www.hp.com. I'll now turn the call over to Leo.

Leo Apotheker - *Hewlett-Packard - CEO*

Thank you, Steve. Since becoming CEO, one of the most commonly asked questions has been what does HP do well and where does HP need to improve? With one full quarter under my belt, I now have an insider's perspective on the answer. For starters, I'm convinced that we have the core strength to deliver for our customers, partners, employees and shareholders. When you look where the market is heading with cloud and connectivity converging, HP is well positioned to win. I'm confident in our future and our ability to execute effectively. I'm also confident that our business model can sustain our earnings power.

Our Q1 results demonstrate the powerful operating leverage and diversity of our portfolio. We grew revenue 4%, gross profit 10%, operating profit 14%, and cash flow from operations and EPS were both up over 20%. We have a business model that benefits from scale and leadership in our core businesses. And we have an evolving portfolio mix with higher margin businesses such as networking, helping to expand Company gross margins. As we discussed during the last earnings call, gross margin expansion allows us to invest for future growth. Q1 operating profitability, both in dollars and percentage, was strong and demonstrated sound financial discipline. But, our Q1 results also show that we have opportunities to improve our growth in a few isolated areas. Despite strong profitability and cash flow in the quarter, we did not meet our top line growth expectations and I'll provide some specific color on PSG and services.

Let me start with PSG which declined 1% year-over-year. Going into the year, we made a few assumptions about the PC market and our business. First, we assumed that we would enhance our number one share position. Indeed, in the most recently reported calendar quarter, HP grew its worldwide sequential share in every category -- consumer, commercial, desktop, notebook. HP holds the number one share in both desktops and notebooks. Second, we assumed that we would capitalize on the growth in the commercial markets. Again, in Q1, we grew commercial PC planned revenue by 11% year-over-year, showing good growth in each region. We also assumed that we would execute our recovery plan in China. In Q1, we grew our PSG China revenue 25% sequentially. We're showing good progress but we still have work to do.

Finally, we assumed that we would deliver growth in consumer. Unfortunately, this did not play out in Q1 due to softness in the [overall] consumer PC market. Our consumer PC client revenue was down 12% year-over-year. PSG continues to demonstrate solid execution, leveraging its portfolio breadth, geographical reach, and customer diversity. Despite the soft consumer market in PCs, PSG's operating profits increased 27% year-over-year, delivering 6.4% operating margins. Most importantly, I'm very pleased with our February 9 announcement. We are all excited about our webOS platform, the devices that we announced and incremental opportunities that webOS provides. The enthusiasm and anticipation for webOS exceeded even our most optimistic expectations. We look forward to providing a differentiated seamless experience across our tablets, smartphones, printers, PCs, and future form factors.

Moving to services, we had a mixed performance in the quarter. Again, we made a few assumptions going into the year. We assumed that we would increase long-term signings, helping to solidify a steady annuity-based revenue stream. In Q1, we achieved this goal, delivering solid signings including a $1.4 billion deal with E.ON, and a record number of mega deals, each greater than $100 million total contract value. We also assumed growth in HP product flow-through with Enterprise Services. In Q1, we continued to show strength, growing our pull-through of double-digit year-over-year.

Finally, we assumed that our project-related short-term higher value-added services would generate a relatively higher growth rate than the rest of our services portfolio. It is consistent with the expected market growth rates for value-added services. But in Q1, we did not achieve our expected level of short-term signings or project-based revenues. This impacted both our Application Services and our IT outsourcing revenue for the quarter. We have a significant opportunity in services. In fact, when I meet with customers, they're asking HP to increase our relationship with them, whether it be helping them to consolidate data centers, modernize their applications or transition to hybrid cloud environments.

So what are we doing to improve our growth in higher value-added services? We're continuously strengthening and enhancing our sales and delivery capabilities. The services transformation efforts announced last year will help automate and improve our processes and tools which we expect to result in better competitive position in the market. We've made good progress on new service offerings like our one-day cloud development workshop where HP cloud consultants work with customers, to map the options of cloud computing. We continue to improve our higher value-added service offerings and ability to serve and deliver both long-term and short-term signings. We have a real opportunity to drive more value to our customers, and that's what we're focused on doing.

Q1 demonstrated the power of HP's robust portfolio [in] our existing core businesses as well as new product launches and innovations. In addition to our successful webOS launch, we achieved other highlights over the past quarter. ESSN delivered another strong quarter. Our networking business continues to be an exciting opportunity; it's a big market. It has good margins and we expect to continue gaining share. In Servers and Storage, we are demonstrating how innovation like Blade System Matrix, Virtual Connect and StoreOnce is driving growth. We are also demonstrating that we can integrate best-of-breed technology into HP, with the 3Par acquisition off to a strong start . The recent security acquisitions in software, both ArcSight and Fortify are also off to a strong start.

Enterprises are going through a transformation with the consumerization of IT and a shift to cloud computing. With our integrated management and security offerings, HP provides a completely different approach to Enterprise Security and Compliance and our Software Security portfolio had a strong performance in Q1. In January, we announced several new cloud solutions, including our ECS-Compute. This is an enterprise-class Cloud service offering, bringing a new paradigm of computing to businesses. We'll leverage our strength of HP's scale, enterprise-class security and reliability, and our unique ability to manage hybrid IT environments. Last week we announced our intent to acquire Vertica. With this acquisition, we will strengthen our capabilities for information optimization, adding real-time business analytics for Big Data. Just like we have with other acquisitions, we'll use our scale and reach to drive Vertica's growth. At the same time, we'll bring new value to HP customers and our eco-system.

IPG continues to innovate and execute its strategy, delivering another strong quarter with 7% revenue growth and share gains in both laser and ink. It was a balanced performance across regions, driven by strength in commercial. Commercial units were up 33% year-over-year, and graphic arts posted strong double-digit growth. As I stated in my opening remarks, HP is well positioned to lead the IT industry. If you use Q1 as a marker, it's clear that we do a lot of things well at HP. But it's also clear that we have isolated areas that we need to improve. I'm committed to making these improvements to provide increased growth and operational excellence.

As you all know, I'll be hosting a strategy summit on March 14 in San Francisco. Here is what you should expect from the event.

I'll go over HP's strategy and how it will continue to evolve.

I'll talk about the opportunities we see in a more seamlessly connected world, from the enterprise to the consumer, leveraging our strengths in cloud and connectivity, and the portfolio of hardware, services, software, and solutions we need to make that happen.

For those of you who will be in person, you also have the opportunity to interact with many of our senior leaders.

It's not a meeting where we lay out long-term financial plan or guidance. It is a discussion of where we see the market going, why HP is uniquely positioned, how we expect to win. The March 14 Summit will be my first chance as HP's CEO to engage with many of you in person, and I very much look forward to seeing you there.

I'll now hand the call over to

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

Thanks, Leo. HP continued to demonstrate disciplined execution in Q1. We added over $1 billion of revenue growth, expanded gross margins and operating margins, grew earnings per share by 27% year on year and generated $3.1 billion in cash flow from operations. Before I get into the details of the quarter, I want to review our annual reclassification process. Each year, as part of our first quarter annual financial review, we make changes across and within the reported segments to reflect organizational shifts between the businesses. This year, we've made several changes that I will now highlight for you.

As I told you in the fall, Networking has moved into the renamed Enterprise Servers, Storage and Networking segment from Corporate Investments. In addition, the communications and media solutions business transferred from HP Software to Services, and the business intelligence business moved from HP Software to Corporate Investments.

A detailed bridge of these changes, including historical data, is available on our Investor Relations website as well as furnished on a Form 8-K filed with the SEC. I want to be very clear that this is an annual process designed to align our financial reporting structure with business changes and that the changes do not impact HP's previously reported consolidated net revenue, earnings from operations, net earnings, or EPS. However, in the interest of complete disclosure, we felt it was appropriate to mention them at the start of this call.

With that, let's review the details of the quarter. Revenue for the first quarter totaled $32.3 billion, up 4% from the prior year.

We continued to see good performance in our commercial hardware businesses, led by strength in converged infrastructure and commercial printers and PCs. We posted solid double-digit revenue growth across these businesses, with Enterprise Servers, Storage and Networking growing 22%, and commercial printer hardware and PSG commercial revenue increasing 13% and 11%, respectively.

Looking at our results by geography, .revenue in the Americas and Asia-Pacific increased 6% and 7%, respectively, while revenue in EMEA was flat year on year. Excluding China, Asia-Pacific achieved double-digit revenue growth. On a constant currency basis, we saw balanced growth with revenue up 5% in the Americas, 4% in EMEA, and 2% in the Asia-Pacific region.

Gross margin in the first quarter was 24.4%, up 1.5 points from the prior year demonstrating the Company's ability to sustain gross margin expansion as we outlined at our Analyst Day in September. The increase in gross margin was due to a favorable mix of HP Networking and PSG and to a benign commodity pricing environment.

Turning to the expense side, total operating expenses were $3.9 billion, including the benefit from net gains primarily associated with the real estate sale announced previously. Excluding these net gains, operating expenses were $4.1 billion, increasing year-over-year, due to both investments in R&D and sales coverage and as a result of acquisitions. We will continue to be prudent in our investments and actively monitor their progress. These results demonstrate our ability to modulate our expenses in a way that enables us to balance investment in the businesses while delivering strong results to shareholders.

Non-GAAP other income and expense yielded a net expense of $97 million, as benefits from net currency gains and other income partially offset other expenses. We delivered non-GAAP operating income growth of 14% year on year, to $4 billion, or 12.4% of revenue including an 80 basis point positive net impact from real estate. Excluding these gains, non-GAAP operating margin expanded 40 basis points as gross margin expansion more than offset the incremental investments in sales coverage and R&D.

First quarter non-GAAP net income improved year-over-year to $3 billion, and non-GAAP diluted earnings per share increased 27% to $1.36.

In the first quarter, HP continued to execute our vision for the nextgeneration data center including all aspects of the converged infrastructure from storage, servers and networking to software and services.

The Enterprise Servers, Storage and Networking business grew 22% to $5.6 billion, with balanced growth across every region. Operating profit for the business was up 36% to $828 million for the quarter, with operating margin of 14.7%, an increase of 150 basis points the prior year, demonstrating the operating leverage in the business model.

Our Industry Standard Servers remained number one in share across all three regions with revenue growth of 17% and ESS blade revenue increased 23% year-over-year.

Revenue in Business Critical Systems was flat year over year. The SuperDome 2 systems are resonating well with customers with strong growth in the Americas, offsetting uneven performance in the other geographies.

We continue to make good progress on our program to displace competitive Unix products in Q1.

Storage revenue increased 14% from the prior year, led by strong growth in our scale-out products and data deduplication technology. Integration of 3PAR is ahead of plan, And we saw continued interest from both existing and new customers. We are on a path to leverage HP's broad channel and enterprise sales force to expand 3PAR's routes to market.

HP Networking grew 183% including the acquisition of 3Com. With over 30% growth in our routing and switching business, the proof of concept program is yielding results. We added more than 40 new accounts including DreamWorks and SHI.

Services delivered revenue of $8.6 billion, down 2% from the prior year quarter, and down 1% excluding the impact of the divestiture of ExcellerateHRO. Services segment operating profit in the quarter was $1.4 billion, or 16% of revenue, up 30 basis points from the prior year driven by continued transformation of our service delivery.

IP outsourcing revenue was down 1% year-over-year and flat in constant currency. The business had good long-term contract signings. This business continues to generate solid revenue streams, driving healthy product pull-through and profitability.

Application Services was down 3% year over year as we didn't get the short-term project work needed to produce the revenue growth we were expecting. We are redoubling our focus and have added new leadership to the team. In addition, we are strengthening both our solutions offerings and our sales coverage to improve performance in this business.

Technology Services revenue declined 1%, and Business Process Outsourcing revenue was down 10% or down 2% excluding the impact of a divestiture of ExcellerateHRO. As Leo outlined, our services business had a mixed overall performance in Q1 and we are taking actions that we expect to have a positive impact in the coming quarters.

HP Software revenue of $697 million was up 5% compared with the prior year, led by 9% services growth; license and support revenue increased 3% and 5%, respectively. First quarter operating margin was $123 million, or 17.6% of revenue. We are pleased with the performance of our security portfolio, including the acquisitions of Fortify and ArcSight.

Turning to Personal Systems. PSG delivered revenue of $10.4 billion, down 1% from the prior year and flat in constant currency as softness in the consumer markets and our challenges in China offset our strength in commercial markets. Desktop revenue grew 1% while total Notebook revenue was down 5% year-over-year. The commercial refresh continues. Commercial Client revenue grew 11%, led by another strong quarter in Workstations, which generated 43% revenue growth. We maintained our market leadership in commercial PC's and continued to expand share in the US enterprise segment by focusing on winning new accounts from competitors, and expanding our channel programs.

Consumer client revenue was down 12%. The consumer softness was predominantly in netbooks, consumer desktops in the US, and notebooks in China. In China, we saw good progress in our plan to restore growth, driving 25% sequential revenue growth in that market. In addition, we exited the quarter with a healthy mix of new products in the channel.

Segment operating profit totaled a record $672 million, or 6.4% of revenue, up 140 basis points year-over-year, as PSG benefited from favorable component pricing and a more favorable product mix.

Moving on to Palm which is included in Corporate Investments. I hope you saw the webOS event on February 9, where we announced the TouchPad and two new smartphones- the Pre3 and the Veer.We've been working with the developer community to build out the application ecosystem and are pleased with the progress so far. WebOS provides a differentiated platform that, over time, will redefine the user experience across HP's device solutions from consumer to enterprise and from smartphone to tablet to other devices.

The Imaging and Printing business delivered strong performance in the first quarter with revenue growth of 7% to $6.6 billion, led by commercial revenue growth of 13% and supplies growth of 7%. Segment operating profit totaled $1.1 billion, or 17% of revenue. Total printer unit shipments increased 13% with commercial and consumer printer units up 33% and 7%, respectively, as we gained market share across all printing categories with particular strength in higher usage segments.

We continue to see solid momentum in our growth initiatives and to lead the market with innovative new products. Our graphic arts business grew double- digits and we are pleased with the momentum in our web press business. Our color laser and multi-function printer units grew 20% and 63%, respectively, while business inkjet unit shipments increased double- digits from the prior year and shipments of wireless printer units more than doubled. In addition, we shipped more than 3 million web-connected printers in the quarter. We will continue to target these markets aggressively, leveraging our technology leadership to drive the shift from analog to digital printing.

HP Financial Services continues to deliver strong consistent results. In the first quarter, financing revenue grew 15% to $827 million. Financing volume increased 10% and net portfolio assets increased 14%. Operating profit of $79 million compares to $67 million in the prior- year period.

Now on to the balance sheet and cash flow. Our balance sheet remains strong. We closed the quarter with total gross cash of $10 billion. Our first quarter cash conversion cycle was 21 days compared with 16 days a year ago, due to the linearity in the quarter. In Q1, days sales outstanding increased four days, inventories were flat, and days payable decreased one day. Channel inventories in each business ended the quarter within acceptable ranges. We generated operating cash flow of $3.1 billion, and free cash flow of $2.7 billion.

During the quarter, we returned $2.5 billion to shareholders, through both share repurchases and dividends. At the end of the quarter we had roughly $8.6 billion remaining in our current share repurchase authorization.

And now a few comments on our outlook for the second quarter and full fiscal year. Given the consumer environment we saw in Q1 and the slower growth in our services business, we are revising our full year outlook and we now expect revenue of $130 billion to $131.5 billion. For Q2, we expect revenue to be $31.4 billion to $31.6 billion.

Regarding earnings, there are a few variables to keep in mind. We will continue to fund investments to drive long-term growth. And we expect OI&E expense of approximately $600 million for the fiscal year; a tax rate of 22%, and a more modest decline in weighted average shares outstanding than we had from Q4 to Q1. We expect weighted average shares outstanding for fiscal '11 to be 2.21 billion shares. Thus, we expect second quarter earnings per share to be in the range of $1.19 to $1.21.

For the full year, we are raising our non-GAAP EPS outlook. We now expect non-GAAP EPS to be $5.20 to $5.28, representing growth of approximately 14% to 15% for the fiscal year. With that, we will now open the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)Your first question comes from the line of Ben Reitzes of Barclays Capital.

Ben Reitzes - *Barclays Capital - Analyst*

I'd like to understand the services shortfall a lot more. The restatement makes it a little murky but versus my prior estimates, looks like $600 or $700 revenue lighter in services than expected and you mentioned Applications Services but looks like it's more on the outsourcing side. So if you can discuss in more detail what the shortfall is in services and what exactly are you doing about it to get that growth rate up? I'd appreciate it, thanks.

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

Thanks, Ben. So services as we mentioned did have a mixed overall performance this quarter. It had solid long-term signings. It, obviously, had good margin expansion and we drove pull-through, product pull-through in the double digits. The long-term signings have been primarily in the ITO space and frankly, over the last few quarters it's been a nice mix of both new logos, but also renewals. In Q1, as an example, we signed a record number of mega deals. Those are deals that are greater than $100 million in TCV and more than half of them were new logos, so we're making progress there. These solid long-term signings are helping us to build, what I would consider, a foundation of solid annuity-based revenue.

But the softness came in our short-term signings. And the short-term signings really are in the space of both ITO as well as Application Services because there are short-term deals in ITO. We call it add-on work. Also in services, I think you need to take a look at technology services because as reported technology -- I'm sorry, technology services declined 1% but it's -- we made a decision about a year ago to stop selling some low-margin third-party hardware and that is generating good business, it's a good business decision for us but it's generating a headwind of about 3 points of growth in the technology services space. And so that means that technology services, instead of really declining 1% on, what I would call a go-forward basis, is actually up on 2 points. In constant currency, our services business was basically flat year-over-year when you adjust for the third-party revenue headwind, and the divestiture of ExcellerateHRO. That doesn't mean that we don't think that there is an opportunity to improve in the short-term space.

Leo Apotheker - *Hewlett-Packard - CEO*

So then let me maybe address the question of what are we going to do about it? So as Cathie has already outlined, we need to do a much better job in our higher value-added services. Services that we deliver to our customers and what is apparent in Q1 is that we have some work to do. We need to do a better job in setting short-term value-add projects into our installed base and actually also add new customer logos. We have taken some very specific actions. We are redoubling our senior management focus on this business and we have added new leadership to the team.

We will continue to invest in our capabilities to serve and deliver long-term and short-term deals. We will continue to improve our internal processes so that we can drive our services delivery transformation. We'll continue to emphasize new types of higher value services like some of the cloud services that we recently launched. For example, we launched cloud development workshop in Q1 and those have already generated more than $250 million of pipeline.

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

Maybe one other piece of information that you -- everybody would be interested in is, is basically that with the actions that Leo's outlined, we do expect to have an improving position in services. For the year, we now expect services to grow low single digits and we expect the growth to ramp over the course of the year.

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

Next question, operator.

Operator

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. I wanted to follow up here first, should we think about the need to redouble senior management and services as an isolated event? I think a lot of investors are going to be wondering if there's a spillover elsewhere in the business. My question is more for you, Cathie. As far as the outlook, can we understand more about the puts and takes to the operating margin profile for the second quarter, please?

Leo Apotheker - *Hewlett-Packard - CEO*

Let me maybe answer the first part of your question, Mark. What we intend to do is to continuously drive our portfolio of services and short-term value-added services into the market. That is part of the transformation that we are undertaking in the Enterprise Services business that HP had already undertaken before. We need to continuously drive this and, therefore, you'll see us paying a lot of attention to this effort.

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

Mark, let me take your question in two pieces -- in gross margins and in OpEx. So from a gross margins perspective, we did benefit this quarter from a benign commodity pricing environment. We also benefited from an improving business mix as well, largely due to network, less importantly -- I'm sorry, less largely due to PSG as well. But we don't expect the component prices to continue to be a benefit for us or as big a benefit in Q2. So what we're calling for basically from a gross margin sequential perspective is that it will be a little bit less uptick from Q1 to Q2 than what we have seen historically. So that's gross margins.

In terms of OpEx, you absolutely have to adjust the OpEx trend for the net real estate gains that are in OpEx. So our OpEx, our admin is actually understated by roughly $250 million of net real estate gains in Q1. If you take that out of the equation, we expect OpEx will increase sequentially from Q1 to Q2, due to normal seasonality and the salary increases that we talked about in the last quarter. Obviously, all of this, both the gross margins as well as the OpEx increase from Q1 to Q2 is completely factored into our guidance for Q2.

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

Next question, please.

Operator

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

Richard Gardner - *Citigroup - Analyst*

Thank you. Cathie, I was just hoping you could give us a sense of what the real estate gain was versus your expectations in the quarter?You had guided non-GAAP EPS to $1.28 to $1.30. Was the $250 million, what you expected there, and do you expect any of that to recur going into Q2?

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

Richard, unfortunately it's a bit more complicated than that. So what we talked about last quarter was roughly a $0.04 gain from one-time items, principally related to real estate. The way the accounting actually worked is that it had to be split across two different lines in the P&L. So there's roughly a $250 million benefit in admin, obviously above operating profit, and then there's a roughly an $80 million headwind or additional charge in OI&E for a net gain of roughly $0.05. As I mentioned, we thought originally that it would -- it rounded to $0.05. It was going to be roughly $0.04 when we talked at the end of last quarter.

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

Next question, please.

Operator

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

Kathryn (Katy) Huberty - *Morgan Stanley - Analyst*

Thanks, good afternoon. Cathie, of the $2 billion reduction in full-year revenue, how much is PC related and then as a follow-up, what inning do you think we're in, in the commercial PC refresh? And if we were to see a deceleration in the commercial PC market like we have in consumer, what would be the Company's strategy as it relates to adjusting the cost model so that, that weren't to derail the earnings story or the multiple investors are willing to pay?

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

Well, Katy, in terms of our revenue guidance, both for Q2 and the full year, we do remain cautious about the environment for consumer spending, specifically around PCs. So we factored that cautiousness into our outlook as well as the fact that the HP Services will grow in from Q1 to Q2 below historical seasonality and then start to improve thereon, but there would still be an overall full year impact as a result of the short-term signings softness that we saw. And I think it's important when you think about our guidance whether it's the top line or the bottom line, that we remind you that we plan conservatively but we always execute aggressively.

Leo Apotheker - *Hewlett-Packard - CEO*

So let me maybe address the issue of which innings we are in when it comes to commercial PCs. We actually see a rather dynamic market. I would rather say that we are in mid-innings, to use the American expression, and we see good demand for our commercial PCs across all of the regions, all of the Geo's , in particular it's driven by what we do on the desktop, on the workstations, but we also start to see some good recovery across the board for other products. So mid-innings and it's -- this market still has some legs to

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Operator

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

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

Yes, thank you. I was wondering if you could first comment about China. It sounded like China was down pretty materially. You're the only Company that I know of whose Asia growth rate was slower than its overall Company growth rate. Can you explain the dynamics and also specifically, what was your year-over-year change in PC revenues in China in the quarter? And then I have a follow-up, please.

Leo Apotheker - *Hewlett-Packard - CEO*

So, let me address the specific issues in China. By the way, we have already talked about these issues in China in previous calls as well. We have a particular PC issue in China which was caused by some events that occurred about a year ago. Actually, we are progressing in China. Our Desktop and Workstation business is solid in this country and I believe that we are getting past the issues in China and we actually saw some good progress in our plan to restore growth, which was up 25% sequentially.

We exited the quarter with a healthy mix of new products in the channel. We are not yet where we want to be but we are cautiously optimistic about the actions we have been taking in China. It's a big market. It's a very important market. And we are very much focused on getting it right. We have had a series of product refreshes, such as the Pavillion G series and that will help our efforts to rebuild our channel partners in China.

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

If I could ask a follow-up and Cathie, maybe you could fill in the blanks and the numbers specifically? What was China's overall year-over-year growth rate and what was China's PC revenue year-over-year in Q4? And then my separate question is, you missed here on revenue guidance for Q1. You're guiding sequentially for the lowest guidance in nine years, other than 2009, which was the downturn for Q2 in terms of sequential change. So you're -- it sounds like you're expecting things to actually get worse in Q2 and then when I looked at the back half of the year, you're actually guiding above normal seasonality for the midpoint of your range so a pretty dramatic snapback. It feels like, given the majority of your services revenues is outsourcing and driven by long-term contracts, a turn in services of that magnitude doesn't appear to explain all of it. So maybe you can help me with that?

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

So Tony, in terms of the guidance, there is no question that we are being prudent and we're remaining cautious about the environment for consumer PCs. There's -- I mentioned that earlier. In terms of the second half of the year, the reason why you see better than normal seasonality, half over half, is that we do expect to continue to recover, that in PSG, especially in China. We also expect improvement in the short-term signings based on the actions that we're taking in the services space. And finally, in the second half of the year, we'll also benefit from the launch of our new webOS family of products. And so I think that, that just shows what happens in the second half.

In terms of your services comment, one thing that I think is important to understand is that when you sign long-term ITO deals, there's a period of time where there's, what's called transition and transformation. And that period of time is usually the first 12 months to 18 months of a contract and during that time you do not recognize all of the revenue. In fact, a large chunk of the revenue is in fact deferred until the project gets into operations and then it is amortized over the remaining life of the deal. So again, long-term signings are great in terms of building the base but when you're in that period of time when you're building the base, there isn't significant growth.

Leo Apotheker - *Hewlett-Packard - CEO*

Let me maybe add one comment to what Cathie has said. We have been looking very hard at our forecast and I can just confirm that we are very confident in our ability to deliver the updated fiscal year '11 outlook. It's beyond the points that Cathie has already made. We see strength in our other businesses and we have scrubbed these numbers long and hard and we believe that these are the right numbers.

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

Operator, we'll go to the next question. Just as a reminder, we'll ask each of you to keep to one question, please.

Operator

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

Shannon Cross - *Cross Research - Analyst*

Thank you very much. Leo, could you provide your thoughts on the potential for acquisitions during 2011 and your thoughts on acquisitions vis-a-vis HP strategy? And then, if you could just be specific as to whether or not there are acquisitions factored into the revenue growth that was given? Thank you.

Leo Apotheker - *Hewlett-Packard - CEO*

So let me maybe give you a holistic picture on our M&A strategy. In fact, I'm going to have to disappoint you because our approach to M&A hasn't really changed. Across HP's portfolio, we will continue to pursue growth and we'll continue to pursue growth either through organic innovation or we'll continue to partner or we'll continue to evaluate M&A opportunities to make strategic, operational and financial sense in only those who actually fit this equation will enter into our M&A equation. So no real change when it comes to our M&A strategy. Maybe as (inaudible) goes, we might have some opportunity and we'll be looking at them.

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

Shannon, there are -- the only acquisitions that are included in our outlook are the ones that have already closed. There are no new acquisitions included in the outlook.

Shannon Cross - *Cross Research - Analyst*

Is that a change from prior or has that been always how you've guided on revenue?

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

That's always how we've guided on revenue.

Shannon Cross - *Cross Research - Analyst*

Okay. Thank you.

Operator

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

Keith Bachman - *BMO Capital Markets - Analyst*

Cathie, I wanted to ask you a question if I could. 70 days ago, you guys provided guidance. Now it's down $2 billion over the course of when you provided guidance, the end of the quarter, I should say. Is it all in those two areas that you mentioned of services and PCs where that $2 billion delta is coming up from? And then if you could just provide a little bit of color as part of that on what your visibility is on the services side because my understanding is, when you enter the quarter you have a high degree, 90% plus of visibility, at least for the one quarter out period, so I'm surprised to hear some of the outlook difference comes from the services side. Thank you.

Leo Apotheker - *Hewlett-Packard - CEO*

So, let's be very clear about this. The -- what happened in the revenues in Q1 is exactly what we have just described. In fact, we executed well in many of our other businesses like ESSN and IPG. So, it actually all came from these two isolated events we just talked about, which is services and consumer PC business. In services, let's make absolutely sure that we understand that there are at least two different drivers here. One is the outsourcing business which is a long-term business and Cathie has described already all of the mechanics of that business.

And then there is the variable which is the short-term value-added business which can actually fluctuate significantly from quarter to quarter. In Q1, we had a number of significant issues that we had to address. We have addressed them. Our portfolio is much stronger going forward and with the focus that we're going to put on value-added services, I feel confident that quarter after quarter, we'll be able to pick up the pace and actually meet the guidance again.

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

And let me just add one other thing. In the ITO space, even within ITO, there's really -- there are long-term contracts and long-term signings and then there are short-term ones as well and that's really the project work that goes on within the ITO accounts. And the short-term signings, both from an application services, value-added services and this add-on business in ITO accounts that was softer than what we had anticipated last -- at the end of last quarter.

Operator

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

Brian Alexander - *Raymond James & Associates - Analyst*

Thank you. Back at the Analyst Meeting last September, you indicated you expected 3Com and 3PAR to contribute about 3 points of growth in 2011, which is just under $600 million. Based on the numbers you reported, it seems like you should do much better than that, so I was just wondering if you could update us on your progress and expectations for both of these acquisitions, and specifically where you're finding success? And related to that, if I back into the networking margins, it looks like you're in the mid-20%, that would be operating margins, and I was wondering if you could comment on the sustainability of those margins in the context of perhaps getting more aggressive on pricing? Thank you.

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

I think the comment that I'd make around the acquisitions is that we are -- 3Com, 3PAR, ArcSight, Fortify, Stratavia, the recent acquisitions are all ahead of plan and doing well. So I think that's the answer I'd give you to the first one. In terms of the sustainability of the networking margins, we're not calling for a significant change in those networking margins. Business has been very strong. We have increased the number of proofs of the concept that we're doing under our proof of concept program, growth is accelerating, the networking business is strong.

Operator

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

Maynard Um - *UBS - Analyst*

Hi. Can you just talk a little bit -- I know in certain of your segments, you actually saw good strength in your server and other businesses but can you just talk about the competitive environment, obviously of new entrants like Cisco and Oracle in the space? What are you seeing? Are they having any impact to either pipelines or pricing? Any further clarity there would be great. Thank you.

Leo Apotheker - *Hewlett-Packard - CEO*

So let me try to give a little bit of a perspective, broken down by each of these various product lines. On the service side, we now have five quarters of strong and robust growth. We've had another 17% year-over-year in Q1 on the ISS Indices, standard service side. We are the number one, and I insist on number one, in all three regions in x86 service. We gained market share year-over-year. So that's performing really well. We have a very strong competitive position with our new product, G6s and G7s and we believe we can maintain a very strong competitive position going forward. This is, also by the way, driven by some of the IP that we put on top of these things, such as BladeSystem Matrix that actually help us differentiate our products significantly. When it comes to 3PAR and to the Storage business, we are doing a great job.

Cathie already indicated that integration is going really well. We are focused on the Next-Gen Data Center. Storage is a key part of that. And our 3PAR future-proof technology is a great complement to our strategy and helps us differentiate from our competition there as well. And just to give you an additional color on the networking business, the 3Com integration has been a huge success. We are ahead of plan over the last three quarters and it's a very quickly growing business for us and we'll continue to see very good traction, thanks to the proof of concept approach that we have in sales.

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

And actually, let me just throw out the numbers since I guess I am the finance person. In terms of the Enterprise Switching and Routing business for us on an apples-to-apples basis that was up 30 -- more than 30% for HP this quarter. So it's a good proof point that networking is, is in fact contributing to the growth and to the gross margin profile of the Company.

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

Next question, please.

Operator

Your next question comes from the line of Kaushik Roy of Wedbush.

Kaushik Roy - *Wedbush Securities - Analyst*

Thank you. In the past, you have mentioned that your R&D and sales and marketing will grow faster than revenues. Does that still hold for fiscal 2011?

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

It does and our guidance doesn't call for any pull-back in OpEx and so I think that we're continuing to move forward with the sales expansions that we're doing, the sales expansion in Q1 showed up mostly in Enterprise Server, Storage, Networking and Software. Those were the biggest areas where we expanded our sales footprint and we are continuing to expand R&D through the course of the year as well.

Leo Apotheker - *Hewlett-Packard - CEO*

Let me maybe add to that, that we'll be keeping a very watchful eye on these things and we will be watching on the return we get from these OpEx investments and we'll keep on driving a very modulated approach to these expenses, depending on our performance.

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

Operator, we have time for one more question.

Operator

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

Aaron Rakers - *Stifel Nicolaus - Analyst*

Yes, thanks, guys. I apologize, I'm going to go back to actually Keith's question earlier. So just to be clear, Cathie, you talked about low single digit growth now in the Services business. I think at the Analyst Day you talked about 2% to 4%. If I do the backwards math, that would be about $700 million, $750 million in revenue shortfall. That leaves you about $1 billion left spread across the segments. I guess my question is, are you still confirming your 7% to 9% growth expectation in Enterprise, Server, Storage and Networking as well as the 3% to 4% growth target for the Imaging and Printing segment for fiscal 2011? Thank you.

Cathie Lesjak - *Hewlett-Packard Development Company, L.P. - CFO*

So, Aaron, on earnings calls, we don't typically update our guidance relative to the segments. I've laid out for you, or we've laid out for you, the guidance for Q2 and a full fiscal year from a revenue perspective. I don't have anything more to add to that.

Leo Apotheker - *Hewlett-Packard - CEO*

So this is -- let me just wrap this call up by sharing with you some final thoughts. HP delivered strong margins, earnings and cash flow performance in the quarter and our operational discipline is intact. We continue to show strength in our core markets. We're winning in the data center, we're capturing the share of the printed pages moving from analog to digital and we're well positioned as the world of cloud and connectivity converge. As we discussed, we have some work to do in a couple of areas and I'm confident in our ability to execute our plan. I look forward to sharing more of our strategy with you at our March 14 Summit. Thank you.

Operator

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