



### CORPORATE PARTICIPANTS

#### **Cathie Lesjak**

Hewlett-Packard Development Company, L.P. - CFO

### CONFERENCE CALL PARTICIPANTS

### **Richard Gardner**

Citigroup - Analyst

### **PRESENTATION**

## Richard Gardner - Citigroup - Analyst

My name is Richard Gardner. I'm Citi's hardware analyst. And, we're very, very pleased to have Cathie Lesjak from HP here with us today. Cathie is CFO and interim CEO of HP.

And, before we begin, HP has asked me to tell you that this presentation may contain forward-looking statements that are subject to risks and uncertainties and to please refer to HP's SEC reports for a discussion of those risks.

So, with that preamble, we'll go ahead and get started. Cathie, thanks again for being here.

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

Thank you very much for having me, and thanks for reading our forward-looking statement.

## Richard Gardner - Citigroup - Analyst

Cathie, I was hoping we could start just by reminding the audience what you've said on your most recent call about business trends.

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

We had a really strong Q3. We grew revenue 11%. That was pretty broad-based performance, which was good. And EPS growth was faster than that, at 17%, and that was really driven by— significantly by operating leverage. I think the key is that it's broad-based. All of our businesses basically grew at or above the market from a revenue perspective.

On a regional basis, strong performance there, as well, across all the regions. So we actually had better-than-normal seasonal growth from Q2 to Q3 in all of our regions. We had great balance across the developing countries and strong performance in emerging markets.

And I think, as good as Q3 was, we exited Q3 with a real strong Q4 pipeline of opportunities. So very positive results for us.

## Richard Gardner - Citigroup - Analyst

Okay. And then maybe, if you could, talk a little bit about what you're seeing by geography. And, also, maybe address some of the areas in the quarter where things were not quite as strong.



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

So, from a geographic perspective, as I mentioned, it was pretty balanced. So we felt that, for us, the global performance-- you could really categorize it as kind of solid across the board.

In terms of the areas where-- I'm not sure I'd call it quite as-- you know, not as strong but more around the fact that the market has been a bit-- I don't know-- slower. Coming out of the recovery, basically, infrastructure had aged significantly. And so folks have really prioritized hardware and using their capital expenditures for hardware. And the software and services market has been a bit slower in terms of recovery.

We're feeling really good about our performance there in terms of the leading indicators because we had record signings in services. Some very strong renewals in there as well. But good progress, good leading indicators of some of the recovery in the services space, especially in the application development area, which is good profitability, a little shorter term, so quicker to revenue. And that's starting to pick up as well.

And then, on the software side, we had stronger BTO license growth, which is a good indicator for the future as well.

So we definitely are starting to see some pickup in the software and services, both markets and our performance in those markets.

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

Okay. I know that you had a very strong quarter last quarter in services and renewals. I think several of EDS' largest customers renewed their contracts last quarter. Could you talk about what you saw in terms of bookings and pipeline outside of the renewal activity? We have traditionally thought of application development as being an indicator that we're back solidly in an up cycle again. I'd be interested to get your thoughts on that.

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

We view it that way as well-- that it's a good leading indicator that things are starting to come back, because those projects tend to be a little bit more discretionary in nature. And so, as that has improved, then we've seen a strong funnel the last two quarters in applications development. So, like I said, good indicators there.

Our pipeline is strong. Despite the renewals—that we had some good-sized renewals last quarter, we still have an increase in our funnel year over year. So feeling good about the potential there and the future. We're getting—We're also not only getting good signings; we're also getting good pull-through. So, if you look at the revenue in Q3, pull-through—the broader HP portfolio is basically up over 50% year on year, which is, again, a key proof point around the strategic value of having a services arm like enterprise services.

### Richard Gardner - Citigroup - Analyst

Okay. Well, Cathie, I know that you addressed this on the last earnings call, but I thought it would be a good opportunity today to flesh it out in more detail. Many of the investors that we talk to seem convinced that HP has been under-investing for the last couple years in R&D, sales and marketing, or new business opportunities and that a new CEO will reset the bar when they come on board. Can you talk about why you think that those fears are misplaced?

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

I can. And I think it's probably good to divide that question up into two parts.



Basically, in terms of the comment around - Are we investing adequately, I think that it's important to look back over the last five years in which we've invested something like \$16 billion in R&D. And it's also important to look at the innovation that's coming out of those investments in R&D. And it really shows both an efficiency around R&D, as well as an effectiveness.

If you look at 2010, 2010 we will launch more new products in 2010 than ever in Hewlett-Packard's history. So we are very confident in our products and services because we have such a broad-- broadest industry portfolio and things like [Store One], which is innovation that came out of our labs around de-duplication, our G6 and our G7 industry standard platforms that had industry-unique energy - power and cooling and energy savings that allow you to get great ROI very quickly.

And, frankly, as a CFO-- If any of you talk to CFOs, you'll know that getting a quick ROI is incredibly important, both in 2009 but also going forward because it's obviously important from a capital expenditure perspective. We've also got new innovation in TouchSmart. We've got new innovation in ProCurve networking. We've got new innovation in our Web-connected printers. So there's kind of a series of innovations that are coming out in 2010 and into 2011 that are significantly positive for us.

And I think it's a proof point in the fact that we are continuing to invest for innovation. And what you've really got to sort out is doing it very efficiently and effectively. And that's really what our focus has been. And it's allowed us to do it with, frankly, less dollars.

On the sales side, we made a conscious decision in 2009 to manage the downturn in a different way than many of our competitors by not, basically, downsizing our sales force so that, as we come out of the softness and hit the recovery, we have the people, the feet on the street, and we're ready to go. And, on top of that, we're been making new investments in, predominantly, global 2000 and the enterprise side of the house in sales; but, basically, been doing that throughout 2010. And it sets us up very well for 2011 and 2012 from a growth perspective.

So I'm pretty confident that we've got the right set of investments, and we're continuing to make the right choices.

In terms of will a CEO reset, I think it's important, and I mentioned this on the call, that our 2011 plans are completely baked, they're deployed, our businesses are executing on them. We have this rolling, three-year plan, and it's important because, throughout '10, the businesses knew what they needed to deliver in '11, and they knew what they were going to need to deliver in '12. And then they backup what investments they need to make. And so we've been making investments in '10 for '11, and we will at our security analysts meeting on September 28 provide kind of the guidance that we would typically provide for FY '11. And so the risk that a CEO does a reset is, I think, zero.

I'll also tell you that one of the beauties in the model that we've developed over a number of years is we've got this kind of funnel of cost savings, and they are—additional cost savings are coming through the P&L in 2011 and 2012. And we're able to take some of those savings and put them in our pocket and drop to the bottom line to expand EPS, and then we invest for future growth, whether that's in sales, R&D, or both. And we've been running this model for a number of years already. We know how to do it. The leadership team is completely behind it. I think we'll be in good shape.

## Richard Gardner - Citigroup - Analyst

I think part of what makes it difficult for investors to benchmark you against other companies in terms of R&D investment is that you have such a diverse portfolio. And, at this point, services, which is not an R&D-intensive business, is 40% of your operating profit. Could you talk about maybe how you take a look at each of the individual businesses and how you feel like you stack up against industry-leading competitors in terms of R&D as a percent of sales?



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

It is important to look at HP on a dis-aggregated basis because PCs have been growing pretty rapidly as well as a percentage of our revenue. And the R&D around PCs has been relatively low as a percentage of revenue. But we basically do look at it segment by segment and then think about where we want to put our R&D dollars.

And one of the things that has really allowed us to bring down R&D dollars, which I know feels concerning to people, is the fact that there are IT allocations, there are real estate allocations, there are other shared service allocations that go into the R&D line, which fundamentally allows us to be more efficient because those allocations are lower. They don't change the amount of dollars going to innovation. And if you actually look at the total HP and you look at the number of innovation R&D—innovation engineers across the Company, we're actually up over the last five years. We have not decreased the number of people working on innovation for HP.

And part of that is around having lower allocations. Part of it's around getting more efficient in labs so that you don't-- you actually take advantage of virtualized labs instead of having a lab in every location. It's about also having one quality and test process instead of having multiple ones across the Company. And it's also about making sure that we're doing R&D in the right locations. All of these allow us to be very efficient and effective in R&D and run with a lower percent of revenue than perhaps other companies.

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

Okay. My understanding, as well, is that, in areas that are very R&D-intensive, like ink jets, you've done a very good job of leveraging the R&D; for example, taking-- using the same print head across consumer ink jets, retail kiosks, as well as production equipment.

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

And we're doing that in the printer space. We're doing that in the enterprise server storage and networking space. I mean, when you think about converged infrastructure, you're basically coming up with, essentially, one box, and that box can be a networking device, a storage device, a compute device, or all three or some combination. And, by having common chassis and industry-standard componentry in the way you build the box up has benefits both from a supply chain perspective but also with respect to R&D because we're leveraging the R&D across that as well. So there are all of these that kind of the scale that you get that most people think about as supply chain is also scale that benefits in the R&D space as well.

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

Okay. And then, on the sales and marketing front, my understanding is that you've increased the size of the sales force by more than 50% during the past five years. I believe those are statistics that you've given out in the past. We've also heard that you're still aggressively hiring sales specialists in the areas of networking storage and servers. Can you talk a little bit about the pace of hiring there and whether that's picked back up now that the economy is improving or whether it's been pretty steady throughout the downturn?

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

We actually-- Let's step back and talk about how we decide where we want to invest from a sales perspective, because what we do is we look at our total addressable market, and we break it down into the pieces and then look at how well we're covering those areas. And, when you look at the enterprise business, where we have the biggest opportunity to do better jobs from a coverage perspective, is in in-services. So it's really more about a direct sales force around the enterprise business. And, if you look at the optimal coverage for the enterprise business versus where we are today, that's the biggest gap that we have. And



so that's the area where they're on a steeper ramp in terms of hiring. I will tell you that I think that enterprise service storage and networking is yet a bit ahead of the broader enterprise business as well. We really started aggressively hiring in the networking space first and have continued to ramp in other areas. So I think that we're on a really good pace in that area and, broadly, in EB. In the IPG and the PSG area, the delta between where we really want to be and where we are today is actually much smaller, and it's predominantly S&B space. So it's less about direct feet on the street; it's more like call centers and online service—online capabilities and things like that. So we're investing in that—in field selling costs there as well, although it's less about just feet on the street.

## Richard Gardner - Citigroup - Analyst

Okay. That's a good segue into 3Com because you announced on last quarter's call that 300 of your 1,000 largest customers are already doing proofs of concept with the 3Com product. Could you maybe provide a little bit more detail on, I guess (a) how you got there as quickly as you did, because that's really quick progress; (b) what types of customers you're seeing the most success with; and what types of environments you expect to see that product most successful in, near term?

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

I think the success that we've had— the quick success that we've had in that space is a combination of things. One is clearly the fact that, before 3Com closed, we were already starting to work on the list. But I think even more imply was a clear sign that customers really wanted us to be in the enterprise data center from a networking perspective. They really were looking for HP to take the ProCurve and extend into the data center. They were looking for choice. And they were excited about the 3Com acquisition because not only did they get an opportunity to have choice but the products that 3Com brought to the enterprise data center are on par or better than from competition, whether it's price, performance, capacity, throughput. They just got a tremendous set— or we now have a tremendous set of products in that space. And that has really helped us to move quickly. Customers are excited. The customers are large customers. They're not— They're names that you would clearly recognize as being top companies around the world and just excited to have us there. The proofs of concept are going very well, and we're really seeing some real traction.

From an acquisition perspective, the 3Com acquisition is basically above plan from both a revenue perspective and an operating profit perspective. In fact, the gross margins in that space are better than we modeled by quite a bit. And the interesting thing is this had a real positive halo effect on our ProCurve business. So ProCurve was up 42% last quarter. And their margins are up as well. So it's really given us a nice-- Just having the complete product line has made a big difference to even our plan at the edge. So I would say that we are very excited about the progress we're making in networking. The integration is not completely done yet. There's still more work to be done, so more opportunity there. But off to a great start.

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

Okay. My understanding is that 3Com was generating very attractive 55-- I think, mid-50s gross margins before the acquisition.

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

Higher now.

Richard Gardner - Citigroup - Analyst

Okay. So they've actually gone up since the acquisition?



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

They have. They're up over 60%. And, like I said, it's pulling ProCurve margins up as well - the whole halo effect. Being able to go and talk to customers about the whole stack is incredibly positive and giving us great benefits.

### Richard Gardner - Citigroup - Analyst

That's very interesting because I think most people thought that you would take 3Com's margins down to aggressively try to push the product into the US and Europe (inaudible).

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

We just haven't needed to.

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

Okay. Investors that I talk to seem particularly concerned about your ability to grow the imaging and printing business, given the secular headwinds that we've been dealing with in that business for decades. And I was hoping that you could give us a sense of what the top three or four or five drivers are in that business that give you comfort that you can grow printing and imaging on a go-forward basis.

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

Just to ground you, we already are growing IPG well. In Q3, we grew on top line revenues 9%. We grew our laser jet unit 44%. And we did all of this by-- and delivering over \$1 billion in operating profit in the quarter, at the high end of our range. So the really strong results in Q3 for imaging and printing. And we expect to be able to deliver greater than 30% unit growth in lasers yet again in Q4. So, in total for the year, we will increase both ink jet units and laser jet units double digits. So good progress there.

And then, if you step back and look longer term than just Q4, you really-- You have to look at two things. There are two key variables that drive the performance that we're going to get out of IPG. One is obviously the unique position that HP has in the market. And then the other one is market trends. From HP's perspective, our franchise-- We've built a very strong leadership franchise around capturing pages, as well as delivering document-centric solutions and services, which is growing pretty rapidly. We now have what we consider the broadest industry portfolio, really strong IP, and then the global reach that basically allows us to grow and capture share while delivering this industry-leading profitability.

In terms of the trends that we see, there's the digital—I'm sorry—the analog to digital conversion, which is generating roughly 200 billion additional pages digitally, which is where we play. And we've got a good franchise there to capture some of that, whether it's our [Web press or our digital press] in the graphics area. We're obviously investing heavily in graphics. We're investing in managed print services and retail publishing, all of which have very nice characteristics because the hardware that you install stays installed three to ten years, and you get basically 100% supplies connect. So it gives us a good, recurring revenue stream.

One other area I just want to highlight because we're also a leader in color wireless and ink jet in the office. And those are significant. We think of those as kind of core. But, in the wireless space, a wireless printer prints 15% to 20% more than a comparable, wired product. And the ink in the office product allows us to bring ink economics both to HP as well as to our customers in the low-end laser market. So it allows us to play in a market that we have not played in as much because the value proposition in terms of the investment in the hardware and in the supplies had not been as good when it was in laser. But, when you do it in ink-- and we've just been growing really rapidly, both in wireless and in ink in the office.



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

Okay. And, in the commercial printing space, it's obviously a great opportunity with the 200 billion pages a year you talked about transitioning from analog to digital. How big--? Is that business becoming significant for HP at this point?

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

It's getting there. If it continues to grow the way it's grown the last few quarters, it gets there faster. It still has a ways to go to be really significant. But the potential is definitely there. Obviously, 2009 was a tougher year for that market because it tends to be print service providers and big capital investments that last for many years. And 2009 was a tough year. But we're definitely seeing the uptick in 2010 and a lot of demand for our digital presses, for even our DesignJet, which is significantly our signage products from [Cytec], both in latex and other eco-friendly inks so that it's a really solid business and growing well.

And the retail publishing is-- We're building up store fronts pretty rapidly. We're up-- We keep adding something like 2,000 store fronts a quarter; so, doing well in that space as well.

## Richard Gardner - Citigroup - Analyst

Okay. And managed print services is also an important initiative for you in that market. I know you hired a Lexmark veteran, Bruce Dahlgren, who's running that business now.

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

Yes.

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

He obviously knows a lot about that business. I think you've said that you have 80 or 85 industry-specific workflow solutions for that market. And I was hoping you could talk a little bit about the momentum you're seeing in managed print services and how the expanded relationship with Canon for copiers has helped you in that area.

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

It's definitely-- The expanded relationship with Canon has definitely helped us because, in order to really go after the managed print services-- the broader managed print services business, you really need to have an offering like the expanded relationship with Canon. The growth-- The way we think about this business now, because of where we are in this growth stage-- we really talk about it as the growth in total contract value. We think about it like a standard ITO-type business. And so we really look at the TCB growth. And that growth has been well into the double-digit, quarter in and quarter out, winning really big deals, really partnering with enterprise services, as well as the managed print services, to basically bring in and cross pollinate deals. So you see deals that now have not only an IT outsourcing component to them but also a managed print services component to it. And that's really allowing us to accelerate the TCB growth in that business. And it's been very positive.

Richard Gardner - Citigroup - Analyst

Okay. Let's talk a little bit about storage.



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

Yes.

#### Richard Gardner - Citigroup - Analyst

You recently completed or, I guess, won the competition for 3PAR with a bid at \$33 a share. I think there are probably many in the room that are concerned about the price that you paid and your ability to get a reasonable concern-- return on that asset. So maybe if you could talk a little bit about what you see the opportunity for that particular product line being and why you're confident that you're going to generate a good return on that investment.

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

We at HP are very excited about winning the 3PAR deal. It is a very strategic position for us because it gives us both a cloud and a service provider offering in the storage space. So, if you think about cloud, storage cloud is expected to grow greater than 40% on a CAGR basis through 2013. So 2013, it will be about a \$6-billion business.

And the offering that 3PAR has is a unique offering in the cloud space, as well as a service provider. It also gives us now our own IP in a big chunk of the high end of the storage market. And it's not so much that that is a huge growth opportunity. The growth opportunity is really in the cloud and the service provider space. But it gives us better margins, obviously. We've now converted from having OEM low margin to higher margin. So there are good margin synergies at the high end of the stack.

And so we just-- We think this is going to situate us very well within our converged infrastructure space, where you really need strong storage offering - especially, a cloud-based storage offering - a networking offering, and a compute offering. And so it kind of builds out that portfolio for us, and we expect to get very significant revenue synergies. Obviously, it's not a cost synergy play at all, although there would be good operating leverage. The margins on 3PAR are in excess of 65% from a gross margin perspective. So, again, this is another example of us investing in the higher gross margin products - networking and now this storage play - that will help move up our gross margin on average and improve our operating margin at the end of the day as well.

#### Richard Gardner - Citigroup - Analyst

Okay. And can you talk about your hurdle rates for these types of investments and where this stacks up versus the typical rate of return that you'd like to get on an investment like this?

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

Why don't I step back? I'll talk a little bit about how we think about M&A first and then talk a little bit about the details around the hurdle rates.

So, from an M&A perspective, and 3PAR was no different than any other thought process around M&A-- The first thing is - Is it strategic? Does it make economic sense? And that's where, obviously, the hurdle rate comes in. And, then, can we operationalize it? And we basically-- In this middle section, where you're trying to figure out whether or not it's economic, what you do is you put together a business plan and a business case. And you basically lay out your cash flows or your P&L and cash flows out a number of years. And then you basically do a discounted cash flow analysis. The discount rate that we use is a risk-adjusted discount rate for a storage play. And the way we come up with that is we basically go out and look at betas for pure-play storage companies and, basically, put that through a (inaudible) and come up with what the discount rate ought to be for that business, discount it. And that basically tells us what the value of that asset is to Hewlett-Packard, both the standalone, plus the synergies. And then, based on that, we come up with what our plan is in terms of how much-- kind of the walk-away price. And, obviously,



we try desperately to get it as low as we possibly can, to keep as much of the economics of the deal for the HP shareholders. Obviously, in competitive situations, sometimes you give away more—a bigger chunk of those synergies to the target company's shareholders. But we always make sure that we get the majority of the synergies for our shareholders.

In the case of 3PAR, obviously, it was a competitive bidding situation. We had a walk-away price. We got it below our walk-away price. And we believe that this will generate more than its cost of capital.

#### Richard Gardner - Citigroup - Analyst

Okay. It seems-- One thing I was thinking about related to the 3PAR deal was that it plays well with what you're trying to do with the most recent services restructuring that you talked about, as well, which is getting customers to bring workloads from their own data centers into HP data centers so that you can get better utilization on your infrastructure resources.

I wanted to ask you about cost. I think there's also a concern in the investment community that, after five years of great cost reduction that you may have exhausted a lot of the opportunity there as well. And so I was hoping that you could talk about that and to give us a sense of where you still see big opportunities on the cost side.

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

Sure. You shouldn't be concerned. We haven't changed our focus on costs at all. In fact, I think about costs in very much the same way, I think, as the salespeople think about their sales funnel. We look at our cost funnel—our cost savings initiative funnel. And we've got items in this funnel that are just about to deliver full-year run rate savings in '10 and '11 and '12. And then we've got ones that are kind of midflight. We've got some at the early part, and we've still got a whole bunch at the idea stage - things that we know we can do. We haven't fully quantified them. We haven't operationalized them yet. But the net result of this entire funnel is billions of dollars of cost savings.

And everybody knows what the funnel looks like and what we've got to execute on. It's embedded in-- The savings that are coming from this funnel are embedded in the 2011 plan or embedded in the 2012 plan.

And so that focus on cost initiatives, I don't think, ever changes. I think that you-- We're going to constantly be refreshing this funnel because we want to continue to be cost-efficient and, frankly, cost-advantaged in the market, so we continue to have this opportunity to, again, take some of the cost savings and drop them to the bottom line and invest, basically, in the future of HP and continue to grow EPS, basically, faster than our revenue growth.

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

Okay. And some of the key opportunities you've talked about in the recent past are real estate, supply chain, and service as being three big opportunities. Can you talk a little bit about what you're doing in each of those areas?

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

Sure. In terms of the pan-HP supply chain, which, again, is a savings opportunity in the billions, it's really about reducing the complexity in the supply chain. So you've got no consolidation. You've got other logistic consolidations that are going on. But it's not just that. It's also making sure that we're getting all the procurement leverage at every-- kind of every component part. It's also about, frankly, reaching back and talking to R&D to make sure that they are designing for manufacturability and making sure that we are, from my point earlier around enterprise-- I'm sorry-- converged infrastructure and leveraging all the common parts that you can, whether it's a particular screw or it's a whole chassis or it's a chipset-- whatever it is. And so it's kind of all of those rolled into one.



We expect that that's going to deliver significant savings for us, and it's going to take-- It takes a while to do all of this. And so it's kind of an end of 2012 timeframe for that set of initiatives. And we've been seeing savings quarter in and quarter out as we speak. So it's not like they all come in at the end. They have been coming in over time-- over the last-- I would say the last three quarters.

From a real estate perspective, the real estate initiatives that we have we announced—I think it was May of 2009—in which there was an additional opportunity within the enterprise services space to basically do more real estate consolidation. It would generate, 2012/2013, about \$500 million more in savings. We expect to invest most of that back into the services business.

And then the last services initiative that we announced in June of this year, in which we took a restructuring charge that basically looks at, basically, modernizing and automating our data centers - our trade data centers - and consolidating them, looking at consolidating our network and doing a number of the next generation of savings adjustments. And that will generate about \$1 billion in savings, kind of 2012. And we expect to drop \$500 million to \$700 million of that to the bottom line.

So we still—For a services business today that our guidance out there is 15% to 17% from an operating profit perspective, we are going to generate, yet again, some additional margin upside in the services space from these initiatives.

### Richard Gardner - Citigroup - Analyst

Okay. And I think \$500 million to \$700 million is worth about a point and a half or two points on services operating margins. Okay.

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

It's a nice impact.

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

It is substantial. I'd like to ask you-- We talked a little bit about converged infrastructure earlier. And there are a number of companies that are going after that opportunity. So I was hoping that you could give us a sense of why you think HP is better positioned to take advantage of this trend than some of the other players in the market, like Cisco, for example, that are pursuing it as well.

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

In order to really realize the full potential from a converged infrastructure, I think you need IP in networking, IP in storage, IP in compute. I think that's kind of a minimum that you need in order to really be able to deliver on the converged infrastructure from a platform and capability perspective.

But you also need to be able to wrap that around with software—management software, so you can manage it and automate the management of the converged infrastructure. And then I also think it's really important to have services that wrap all around that in terms of being able to deliver that service any way the client wants it, whether it's in the cloud, whether it's in an outsourced service, or it's actually onsite for them.

And there's nobody else out there, no matter who you talk to, that has IP in all those different pieces of the converged infrastructure. So I believe that HP is uniquely positioned, and we're certainly seeing very good response from our customers that we talk to around this area.



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

Okay. Now, I realize it's a small part of your business. It's only 10% to 15% of your operating profit. But I did want to ask a PC question because you've been a consistent share gainer in PCs for many, many years. And I think this last quarter was the first quarter in many years where you had not gained share. You grew at less than the market rate. Is this a temporary issue in your view, or is there something bigger that we should be worried about? Is it a situation where you've had some competitors struggling for the last couple years, and they're finally starting to get their act together? How would you characterize what's going on in that business?

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

At some level, I would characterize it as we're continuing to do what we've always been doing, which is really focusing on profitable growth. We have maintained or gained revenue share in that space. But the key is, basically, focusing on profitable growth, having the right kind of portfolio of products available out there.

And, frankly, we feel good about the results that we're generating. We grew revenue last quarter 18% or 19% and have a very broad portfolio. We have real opportunities in-- frankly, in desktop virtualization area, where we're number one in that market and are starting to see some really positive signs as some of the financial services companies are being kind of-- leading the market in that space and rolling out more virtual desktop solutions, which is just very accretive to HP.

Lots of people ask me - Isn't that going to hurt your PC business? But it's really-- That is a solution. It's a solution of hardware, software, and services that is margin accretive for the business.

And so we continue to feel good about the PC business and don't really see what's happening there from a unit share perspective as really-- a real change in market dynamics at all.

## Richard Gardner - Citigroup - Analyst

Okay. And, then, maybe, if you could, talk a little bit about the Palm acquisition and the decision process that went into that. I think most people's reaction was that it was primarily for handsets. But I think you've said that, as you took a look at the deal, it was much more broadly applicable than that.

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

If it was just about smartphones, I don't think we would have done it. In fact, I'm sure we wouldn't have. It's just—It wouldn't have made sense for HP. HP was looking for more than kind of a play in the smartphone. We really wanted to be able to have a product offering across, I would say, connected mobile devices, whether it's smartphone, slates, and, potentially, netbooks, where you could take—kind of own the customer experience. And that's the key thing is being able to really have a unique HP customer experience across these connected mobile devices. And that's what the Web OS gives us. So it was really—The Palm acquisition was really about the Web OS and being able to leverage that across the connected mobile devices.

Richard Gardner - Citigroup - Analyst

Including printers, I believe.



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

We're also going to use it for our Web-connected printers as well, which creates an interesting ecosystem from a developer perspective-- right?-- because now you've got millions of printers out there as well. And we'll talk a little bit at the security analysts meeting on September 28 about how the Web-connected printers or kind of the mix of that business is expected to go from the device perspective, which, obviously, gives the developers a very large platform on which they can develop applications that will be very attractive to them.

### Richard Gardner - Citigroup - Analyst

Okay. Well, I don't think I can get through this without asking you about the CEO search and how that's going and for an update on that.

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

Okay. As you all know, we have a search committee. And it's their job to really focus on getting us the best CEO, in my mind, maybe a bit selfishly, as quickly as they can. And I think they're very focused on doing that and very committed to going-moving the process through quickly. We've got Spencer Stuart we've hired, who is not only helping us with external candidates but also helping us, basically, at the internal ones. So they're really kind of the glue that holds those two together. And, like I said, the search committee is actively interviewing. We've been very pleased with the selection of candidates. I think there was some worry that maybe there weren't going to be that many. But that certainly doesn't seem to be the issue. And so now it's just a matter of kind of getting everyone scheduled and through the interview process as quickly as possible so that they can make their decision.

#### Richard Gardner - Citigroup - Analyst

Okay. Is there anything that you can say about the committee's feeling on an internal versus an external candidate at this point?

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

You know, I think that they are pretty open to either. From what I've heard from them in my discussions, they're basically looking at both internal and external, pretty much as we always do. When I got hired four years ago, the-- I was part of an internal and an external search for the CFO. And what we look for is whether or not what you're going to get externally is kind of above and beyond what you might be able to get internally that would justify going external. And there are going to be times when that will be the case, and there will be times when it's-- the value tradeoff that you're going to make is better to go internal. And I think that's exactly how they're thinking about it.

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

Okay. And then I also wanted to ask you about what's going on with Oracle. You've obviously filed suit against Oracle, claiming that your trade secrets are threatened by Mark's move over to Oracle. Could you talk about--? Obviously, the decision to file that suit-- Oracle is an important partner of yours. How do you think that that affects your relationship with Oracle?

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

I think the clarification I need to make is that we actually have not filed suit against Oracle. We have actually filed suit against Mark. And Mark signed a number of agreements to basically keep trade secrets and confidential information confidential.



**Richard Gardner** - Citigroup - Analyst

Right.

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

And it's important for him to be reminded that he signed those agreements.

In terms of how it's going to affect our relationship with Oracle, obviously, with the press that Allison had yesterday, you can imagine it strained it a bit. But I think, at the end of the day, business will prevail. And, ultimately, we will go back to being good partners-- and competitors where we've been competitors and partners where we've been partners, because I believe that HP is important to Oracle, and Oracle is an important partner of ours.

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

Okay. And then I'll end on a better note, and that is-- One question I also get a lot from investors here lately is-- you generate such great free cash flow, and your stock is so attractively priced right now. Why not go out and lever up potentially or use a big portion of your cash to do some sort of accelerated share repurchase?

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

As we announced last week, we are upping our share repurchase so that, this quarter—We announced last week that, this quarter, we will spend more than \$3 billion on share repurchase. That's up from the \$2.6 billion that we spent last quarter and the quarter before, \$1.8 billion.

And I think it's really important to realize that the cost of zero dilution - so, offsetting the dilution from employee benefits plans - has come down dramatically. So, when we spend greater than \$3 billion, we take net shares off-- a significant number of net shares off the table. And we, like you, think that the stock price is very attractive to us, and we would expect to continue to be active at these price levels in our shares.

At the same time that we announced what we were going to spend, roughly, in Q3, we also had our-- We announced that the Board approved an additional share authorization of \$10 billion so that we can, in fact, continue to be active in the shares. And so you'll see us do that.

Richard Gardner - Citigroup - Analyst

Okay. Great. Well, I think we've exhausted our time. But, Cathie--

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

Let me just real quickly wrap up. I just want to say a couple of things.

I think the first one is just to remind you all that we are a very strong company. We're well diversified. We've delivered broadly across the Company for a number of years and, obviously, in recent quarters. From our perspective, we've got the right assets. We've got the right strategy. And, frankly, we've got the right people who know how to execute. And I think that that is something that is now very much part of HP's DNA.



I also talked about the cost savings initiatives that we've got going. And we're not confused. We recognize that that is a huge value proposition that we have at HP - the ability to be operationally excellent and continue to bring down our costs so that we can reinvest and/or expand EPS by dropping a lot of it straight through.

We've got a number of unique, sustainable, competitive advantages that will serve as well, And, at the end of the day, HP is going to deliver for our customers and for our shareholders and continue to be focused on that execution and look forward, frankly, to having a new CEO soon so that we can continue to move forward. So thank you.

## Richard Gardner - Citigroup - Analyst

Thank you. Thank you very much.

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