THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

## HPQ - Q1 2013 Hewlett-Packard Earnings Conference Call

EVENT DATE/TIME: FEBRUARY 21, 2013 / 10:00PM GMT

**OVERVIEW:**

HPQ reported 1Q13 revenue of $28.4b, operating profit of $2.2b and GAAP diluted EPS of $0.63. Expects full-year FY13 GAAP EPS to be $2.30-2.50 and 2Q13 GAAP EPS to be $0.38-0.40.

## CORPORATE PARTICIPANTS

**Rob Binns** *Hewlett-Packard Co - VP IR*

**Meg Whitman** *Hewlett-Packard Co - CEO*

**Cathie Lesjak** *Hewlett-Packard Co - CFO*

## CONFERENCE CALL PARTICIPANTS

**Bill Shope** *Goldman Sachs - Analyst*

**Katie Huberty** *Morgan Stanley - Analyst*

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

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

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

**Brian Alexander** *Raymond James & Associates - Analyst*

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

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

**Brian Marshall** *ISI Group - Analyst*

**Steve Milunovich** *UBS - Analyst*

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

**Kulbinder Garcha** *Credit Suisse - Analyst*

## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the first quarter 2013 Hewlett-Packard earnings conference call. My name is Anthony and I'll 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 call over to your host for today's call, Mr. Rob Binns, Vice President of Investor Relations. Please proceed.

---

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Good afternoon. Welcome to our first quarter 2013 earnings conference call with Meg Whitman, HP's Chief Executive Officer, and Cathie Lesjak, HP's Chief Financial Officer. Before handing the call over to Meg, let me remind you that this call is being webcast. A replay of the webcast will be made available shortly after the call for approximately one year.

Some information provided during this call may include forward-looking statements that involve risks, uncertainties, and assumptions. If the risks or uncertainties ever materialize or the assumptions prove incorrect the results of HP may differ materially from those expressed or implied by such forward-looking statements. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including but not limited to any projections of revenue, margins, expenses, earnings, earnings per share, tax provisions, cash flows, share repurchases, currency, exchange rates, or other financial items, any statements of the plans, strategies, and objectives of Management for future operations and any statements concerning the expected development, performance, market share or competitive performance relating to products or services. A discussion of some of these risks, uncertainties, and assumptions is set forth in more detail in HP's SEC reports including its most recent Form 10-K.

HP assumes no obligation and does not intend to update any such forward-looking statements. The financial information discussed in connection with this call, including any tax related items, reflect estimates based on information available at this time and could differ materially from the amounts ultimately reported in HP's first quarter Form 10-Q. Revenue, 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, amongst other things, amortization of purchased intangible assets, restructuring charges, and acquisition related charges. The comparable GAAP financial information and a reconciliation of non-GAAP amounts to GAAP are included in the tables and in the slide presentation accompanying today's earnings release, both of which are available on the HP Investor Relations web page at www.HP.com. I'll now turn the call over to Meg.

---

**Meg Whitman** - *Hewlett-Packard Co - CEO*

Thank you, Rob. And thanks to all of you for joining us today. As we discussed during our security analyst meeting in October, fiscal 2013 is the second year in a multi-year journey to turn HP around. You will recall that I referred to fiscal 2013 as a fix and rebuild year that would set HP up for a recovery and expansion in 2014. Since announcing our turnaround plan, we've done what we said we would do. We've defined a clear strategy for the Business. We've made significant progress in bringing our costs in line with revenues. Most importantly, we've exceeded the financial performance we said we would deliver.

With the first quarter of 2013 behind us, we're starting to see some traction in our performance as a result of the actions we took in 2012 to lay the foundation for HP's future. While the results in the first quarter were not where we want them to be, we did better than we expected. Let me repeat what I've said so many times before. HP's turnaround will it not be linear, and our primary focus is to deliver on our outlook for the full year. That means continuing to implement critical programs to strengthen our balance sheet, optimize our supply chain, speed innovation into commercialization and demonstrate our product leadership across our markets.

In the first quarter, HP delivered $0.82 in diluted non-GAAP earnings per share, exceeding our financial outlook of $0.68 to $0.71 per share. This is tangible proof that we have the right plan in place and that we are successfully delivering on it. Performance in the quarter was driven by improved execution as well as improvement in our channel and go-to-market efforts. Additionally, the restructuring program we announced in May continues to deliver results. The restructuring program had a meaningful impact on the bottom line in the first quarter, and we expect that will accelerate as we move through fiscal 2013 and into fiscal 2014. In addition to the financial impact, we are seeing the benefits of a streamlined and more engaged organization translate into crisp execution of the business strategies.

As I said before, all this comes down to improving cash flow. In the first quarter cash flow from operations was $2.6 billion, up 115% over the prior year. As we detailed in October, we are maintaining our disciplined approach to capital allocation with a focus on rebuilding our balance sheet. After returning more than $0.5 billion to investors in the form of share repurchases and dividends in the first quarter, we improved our operating company net debt position for the fourth successive quarter by more than $1 billion to $4.7 billion.

Now let me turn to our business group performance in the quarter, starting with the Enterprise group. Overall, I would have to say that I was pleased with the performance improvements the Enterprise group made during the quarter. We are driving incredible product innovation in servers, storage, and networking that is really resonating with customers who are grappling to meet the complex needs of the new style of IT. Revenue from our Converged Storage products increased 18% over the prior year, which includes revenue from 3PAR that was up 21% over the prior year as we continued to innovate. During the quarter, we launched our most significant set of new storage platforms in over a decade, the industry's first converged storage solutions that break through complexities and inefficiencies with a single architecture. These solutions, including the new HP 3PAR mid tier storage and StoreOnce backup products are already gaining traction with our customers.

In Servers, we stabilized our core server business, as our Gen8 products ramped in the quarter due to improved channel execution and better options attached rates. As a result, we expect to grow market share by nearly 1 point in x86 servers over the prior year. In addition, HP ProLiant has been the number one server brand for 67 quarters in a row with an estimated 32.1% of total x86 units shipments share in the fourth calendar quarter. Networking showed continued sustained revenue growth up 6% year over year after normalizing for a divestiture and we believe gaining modest share in the quarter. And, our Technology Services business, which we are now reporting as part of the Enterprise group, continued to deliver strong profitability.

I was also pleased with the performance and improvements we saw in Printing. We grew margins by 3.9 points over the prior year as new initiatives to drive innovation and implement new business models took hold. We launched our new Multifunction printers and document Workflow products in the quarter. These new products are really paying off. In the fourth calendar quarter, we saw year-over-year hardware share gains of 4 points in our All-in-One products and 3 points in Multifunction printers. Overall, we grew ink share by 2 points sequentially over the prior quarter. This was driven by our Ink in the Office program and by products like Officejet Pro, which saw unit growth of 32% year over year. We expect that our recently launched Officejet Pro X, powered by our revolutionary PageWide array technology, will further extend our lead particularly among small- and medium-sized business customers.

Finally we are seeing continued strength from our Ink Advantage program, which has now been expanded to over 120 emerging markets. Ink Advantage Printer placements grew over 350% over the prior year. Clearly, our strategies are driving our Printing business to where it needs to be.

In Personal Systems against a backdrop of overall PC market contraction in the fourth calendar quarter, we gained 1.4 points of market share in PCs over the prior year, including a 4.6 point gain in the US. On the back of our strong execution in the Windows 8 rollout, we once again held our position as the world's leading PC maker. We have really amped up our innovation in the Personal Systems space with a particular focus on the Enterprise.

We announced the EliteBook Revolve, the first major convertible design refresh for commercial managed IT in more than five years. The Revolve was named the best notebook at the Consumer Electronics Show in 2013. We officially released the HP ElitePad 900, the world's first tablet optimized for the enterprise and we are seeing very strong interest for the ElitePad from current and new customers alike. Finally, we with introduced our first notebook powered by the Google Chrome platform. This first step in building out a multiple operating systems strategy in our Personal Systems business will allow HP to effectively meet the needs of both the enterprise and the consumer.

Turning to Enterprise Services, the new leadership team led by Mike Nefkens has moved quickly to stabilize the business. With Q1 margins of 1.3%, we are on track to deliver full-year margins in the target rang of 0 to 3%. The expected revenue runoff in the key four accounts we highlighted at our security analyst meeting was somewhat delayed, and we did a good job managing and selling into these accounts. This, in addition to higher than expected non services revenue, meant total Enterprise Services exceeded out expectations for the quarter. It is still early days, but I believe ES is on track to deliver on the long-term recovery plan we presented in October.

In Software we saw continued strength in our Big Data Analytics business, including high double-digit growth in Vertica over the prior year. We also saw strong double-digit growth in Security where we have momentum building for the rest of fiscal 2013. Now, as I have said many times, our channel partners are critical to our success. So we are also making significant investments to make our channel program simpler, more profitable, and more consistent for our channel partners. At our Global Partner Conference earlier this week, we announced significant changes to our partner programs to address what they want from us, a simplified compensation model, higher rebates for higher specialist designations and new IT investments. They also want more time to use their marketing development funds, and they want simplified sales and technical certifications. In addition, we're rolling out a new platform to improve communications and joint business planning with our channel partners.

Of course, the other critical piece to our turn around is our people. My experience with turn arounds is that they happen from the inside out. If we can mobilize HP's more than 300,000 employees, I truly believe there is nothing we can't do. And I have to say that I am seeing that turn. Just a couple weeks ago we brought together the Company's top 1,000 leaders for a leadership meeting. The passion and enthusiasm I saw for the future of this Company was palpable. I for one walked away more energized then ever.

Turnarounds also happen when old and new customers believe, when they believe in the products, services and consistency of their partners and providers. In HP's case, customers are really starting to believe. Around the world we saw a number of significant customer wins in the quarter, including HP Enterprise Services announced the contract up of to $543 million with the US Department of Veterans Affairs. The program will procure and deploy a management system to assist in the automation and improvement of operations and veteran healthcare services. Luxottica Group, the global leader in eye wear, tapped HP to manage its data center environment. HP will work to create a more agile, secure and scalable technology infrastructure to help them migrate to a cloud computing environment.

All Digital, a leading digital broadcasting solutions provider, selected HP StoreAll Storage to support its future business growth, improve its cloud storage performance and reduce infrastructure costs. Finally, HP was awarded a major contract from the Uttar Pradesh government in India to supply 1.5 million laptops to students in the state.

Now, we clearly still face a long road ahead, and there's a lot we still have to fix and rebuild. I don't like the fact that we saw revenue decline in each of our major segments. We are focused on turning this around. That means innovating in our products, improving our go to market, and implementing new business models. Restoring growth is a priority and we're on it. We're seeing pockets of progress, but as we said at the security analyst meeting, it will take the rest of the year to imbed our plans before we see sustainable progress on the top line.

Let me talk a bit more about the Personal Systems business. It's called Personal Systems for a reason. Personal computing is about much more than the personal computer. It's not news to anyone that there tectonic shifts happening in this market as new form factors continue to proliferate, new operating platforms emerge, and the lines between the enterprise and the consumers blur. On top of that, the pace of these shifts is actually accelerating. There are a lot of reasons why we are where we are in this market, but I truly believe that this is a business we need to be in for three reasons.

First, nobody understands computing like HP, from the data center to the device. Second, the future is convergence. As the complexity of these computing ecosystems go up, our ability to bring pieces together becomes a competitive advantage. Third is security. As these devices become more central to our businesses and our lives, they present greater risk to both enterprises and individuals. HP understands how to balance access and security.

By bringing these three things together, HP can win in this rapidly growing market by marrying form factor with computing power to create the secure personal systems that enterprises and consumers need to drive their businesses and live their lives. It is going to take us some time to get back on track. We've made significant progress over the past year in our mobility strategy with new form factors that are resonating well with customers and multiple operating systems that are going to give us flexibility to meet a variety of customer needs. At the same time, we are continuing to innovate in key computing markets where we already lead, like work stations, desk tops, and notebooks, areas I believe will continue to be critical pieces of the computing echo system. As we navigate this transition, we need to remain focused on the balance between profitability and market share, but it's important to acknowledge that pricing continues to be very competitive. We plan to continue to take actions to improve our margins in Personal Systems as we go through fiscal year 2013.

In the Enterprise group, we are seeing a tepid market in EMEA in servers where we have a significant leadership position and that continues to impact HP. We also saw continued headwinds in BCS and the traditional storage business as we managed that portfolio transition. We have two distinct stories within our Storage portfolio, with our focus area of Converged Storage performing extremely well while we transition away from our traditional storage products. As a result, we will now be breaking out converged storage from traditional storage to give investors better visibility into what is happening with this business. In Servers we are focusing on improving our Hyperscale offering. The first quarter represented a tough comparison over the prior year for our Hyperscale business, which tends to be somewhat lumpy, but we still have work to do in this market to compete profitably.

In Enterprise Services we have to reignite growth and there's plenty of work to do on improving our sales capabilities. Just last week we announced Larry Stack as Senior Vice President of Global Sales for Enterprise Services. He is tasked with reigniting Enterprise Services sales. Larry's a seasoned leader, who has had a strong track record of successfully transforming sales organizations at Accenture, and actually with HP before that. I must say I've been pleased with the quality of talent that ES team has been able to attract over the past few quarters to help them in their turn around.

In Software, we saw weakness in our traditional IT Performance Suite business. We are working to improve our product offerings, business model, and execution to address the drop in license revenue. And our Automony business has begun to stabilize, but it is still a work in process and will take time to get back track.

Overall, our turnaround made progress in the first quarter. If I had to characterize it is I'd say the patient should some improvement and there are a number of new programs and disruptive innovations that should help us along. Two that I'm particularly excited about are the refocusing of HP Labs under Martin Fink and the launch of our first product resulting from Project Moonshot. You will recall that during our security analyst meeting I talked about the need to improve how HP commercializes the incredible innovation that is happening across the Company. Today we are rolling out a new vision for HP Labs that is going to take one of Silicon Valley's most iconic entities to new levels. Martin and the leadership team are refocusing Labs to place greater resources on priorities more closely aligned with the business groups future product road maps, particularly in the areas of cloud, security and information optimization.

Innovation is the heart of this Company and we expect this refocused HP Labs to bring revolutionary new products to market that will change the way we manage, move and interact with information and how we understand the world around us. Later in the second quarter, we will be bringing the latest innovation from HP Labs and our Enterprise group to market, the first, commercialized product from our Project Moonshot. We expect this to truly revolutionize the economics of the data center with an entirely new category of server that consumes up to 89% less energy, 94% less space and 63% less costs than our traditional x86 server environment. This is exactly the technological influction that can fuel the exponential growth of hyperscale computing. To put in that perspective, if just 10 large web services providers switched their traditional x86 servers to Moonshot, they could save a combined $120 million in energy operating expense and nearly one million metric tons of CO2 per year. The equivalent of taking over 180,000 cars off the road for a year. That is a game changer.

Now let me turn to our fiscal second quarter and future outlook. HP's performance in the first quarter was encouraging, but we are not going to get ahead of ourselves. As I have said before, we know where we are going and we have a plan to get there. Now we have to focus on execution. Our Q2 outlook for non-GAAP earnings per share is $0.80 to 0.82 a share. Our outlook for fiscal 2013 is unchanged at $3.40 to $3.60 per share. I'm pleased with our performance in Q1, and I feel good about the rest of the year. So now let me turn it over to Cathie to highlight some of the key factors behind our outlook. Cathie?

---

**Cathie Lesjak** - *Hewlett-Packard Co - CFO*

Thanks, Meg. As you heard, we continue to make the difficult yet necessary improvements to set HP up for long-term success. We are creating new products and services that matter to our customers. We are improving our sales performance and channel relationships and we are recalibrating the expense profile to align with the market and business dynamics we face. At the highest level, I would characterize this quarter's financial results as one constructive data point on the steady, albeit not always linear, progress we expect to make in our turn around journey. Before I dig into the financials, let me explain some segment reporting changes that we have made this fiscal year. Beginning this quarter we are reporting two new business segments, the Enterprise group and Enterprise Services.

The Enterprise group mostly combines the previously reported Enterprise Server, Storage, and Networking segments with the Technology Services business that was previously reported within the Services segment. Enterprise Services then is largely the remaining pieces of the previously reported Services segment including Infrastructure Technology Outsourcing and Application and Business Services. You should note that there were other transfers to appropriately align all of the TS support and maintenance functionality with the appropriates products and services group, and these have been disclosed in detail in an 8-K we published this morning. In that filing, we have reported fiscal '11 and fiscal '12 revenue and operating profit by segment under the new reporting structure to help you understand the historical performances of these businesses under that structure.

Now turning to the results. Revenue was $28.4 billion, down 6% year over year as reported, and down 4% in constant currency. From a global macroeconomic perspective, there are still a number of headwinds, but we are seeing pockets of progress on a regional basis. In Americas, revenue was $12.8 billion, down 3% year over year as reported and in constant currency. Revenue in EMEA was $10.3 billion, down 11% and it 9% in constant currency. Revenue in Asia Pacific was $5.2 billion, up 1% as reported and in constant currency. The US fared better than Latin America, while EMEA continues to experience broad based challenges with several major countries down double-digit percentages. Within APJ, both China and India had strong constant currency growth, while the South Pacific still faces a tough economic environment.

Non-GAAP gross margin of 22.3% was down 10 basis points year over year, due to the tough pricing environment in our Personal Systems markets as well as margin declines within EG and ES. These impacts were somewhat offset by margin expansion in Printing due to rate improvements in ink, hardware and toner as well as a favorable mix shift towards ink supplies. Sequential non-GAAP gross margin was down 190 basis points driven by seasonal revenue declines in Enterprise Services, outpacing expense reductions and printing margin declines as supplies mix shifted to toner. Non-GAAP operating expenses were $4.1 billion, down 1.4% year over year and down 1% sequentially.

The restructuring program announced last May provided savings this quarter in line with our expectations, and on a year-over-year basis some of these savings are helping to drive down our SG&A expenses. Sequentially, R&D declined primarily due to two factors. First, was the impact of value added tax subsidy credits in the current period. Second, was higher expense in Q4 '12 resulting from one-time accelerated contract costs. Despite the favorable impact of the current period vat credits, R&D was up on a year-over-year basis in both absolute dollars and as a percentage of revenue. Non-GAAP operating margin was 7.9%, down 70 basis points year over year, and the Company delivered $2.2 billion in operating profit. Given the macro and specific business challenges we face this quarter, the overall profit story came in better than we had anticipated, and while we know we have more work to do, this is a step in the right direction.

The bridge from non-GAAP operating profit to non-GAAP earnings per share includes the following. Other income and expense of $179 million in expense. A tax rate of 22%, a 2% reduction in our weighted average share count to 1,956 million shares, and we used $253 million in Q1 to repurchase 19.2 million shares. As a result, we delivered non-GAAP diluted earnings per share of $0.82 and a GAAP diluted earnings per share of $0.63. The non-GAAP EPS exceeded the high end of our outlook we provided at the last earnings call by $0.11, or 15%. First quarter fiscal 2013 non-GAAP diluted earnings per share excludes pre-tax charges of approximately $350 million from the amortization of purchased intangible assets, about $130 million of restructuring charges, and a very small amount of acquisition related expense from prior acquisition.

Now on to the business segments' performances for the quarter. Personal Systems delivered revenue of $8.2 billion in the quarter, down 8% year over year with operating margin down 2.5 points to 2.7%. Operating profit of $223 million amounted to just 10% of HP's overall non-GAAP operating profit in the quarter. Total units shipped were down 5% versus prior year, driven largely by declines in notebooks, desktop units were up solidly this quarter. By category, commercial revenue was down 4%, and consumer revenue declined 13% year over year. Europe was a challenge but we continue to see positive traction in APJ, with some of the channel improvements that Meg described showing good results.

Our effective inventory managements positioned us well to capture a stronger share in Windows 8 form factors relative to the competition this quarter. While Windows 8 was not a significant enough catalyst to stem the declines we experienced, we continue to be excited about our new product offerings being placed into the market. But clearly the margins of this business are still not where we want them to be, and the top line pressures, in particular with notebooks, are significant. The business is facing a broader market downturn and we have a lot of work to do to get this business back on track.

Turning to Printing. Net revenue was $5.9 billion, down 5% year over year. The story is largely consistent with last quarter. We continue to realize share gains in high value ink hardware and across our Multifunction portfolio and Ink Advantage is doing well for us. Indigo also had another strong quarter. We think the new ink technology we have innovated for the SMB community is a game changer, and we are launching the Officejet Pro X amidst strong customer interest for the product. Operating profit was $1 billion, or 16.1% of revenue, up 390 basis points year over year.

Supplies were 66% of the mix, roughly flat year over year, and we continue to manage channel inventory down with dollar declines for the sixth quarter in a row in Supplies. Channel inventory is within our acceptable ranges. This represents great progress and is down more than 25% from the peak several quarters ago. By business unit, total printer unit shipment volume was down 11% year over year largely driven by the decline in lower-end consumer as we maintain focus on the higher value units. Consumer printer revenue was down 2% with hardware units down 13% year over year. Commercial printer revenue was down 9%, and hardware units were down 6% versus the prior-year period.

As I mentioned last quarter, the revenue declines are partly attributable to a shift in focus from lower-end printers to the high-end categories where we have seen success with market share gains. As a result of this shift, and our Ink Advantage products, our average selling prices have increased year over year in Printing. We are managing unit placement investments to drive shareholder value over the life of the units.

Turning to the Enterprise group, revenue of $7 billion was down 4% year over year with declines across Servers, Storage and Technology Services. The greatest declines were experienced in EMEA again this quarter. Operating profit was $1.1 billion, and the operating margin of 15.5% was 2.8 points below the prior-year period driven by operating margin declines in each of the business units, slightly off set by a favorable mix shift to

Technology Services. At the business unit level, industry standard server revenue declined 3% year over year. We continue to see specific weakness in EMEA, but there was solid growth in APJ, particularly in China. In our Hyperscale business there was a tough compare given a large deal in Q1 of 2012. As you know, Hyperscale deals can be lumpy in nature. The ramp of our Gen8 ProLiant servers continues to go well and we've seen favorable trends in our average selling prices of these units, too.

Within Storage, overall revenue declined 13% year over year to $833 million. There's a story within a story that is important. So we've added an extra level of granularity to our storage reported revenue this year. We have talked in the past about the successes in our key focus area, Converged Storage solutions. These products are driving the next wave of innovation and capturing the attention of customers. Our Converged Storage products grew 18% year over year while traditional storage revenue declined 21%. This traditional category includes tape, storage networking, and our legacy external disk products such as EVA and XP.

As we've mentioned before, Converged Storage consists of products based on HP's intellectual property, such as 3PAR, StoreOnce, StoreVirtual and StoreAll. The new 3PAR mid range offering we announced in December is driving good year-over-year growth in Converged Storage, and overall 3PAR is continuing to drive year-over-year gross margin improvements in the Storage business. Q1 was the fourth consecutive quarter where gross margins expanded. Business Critical Systems revenue declined 24% year over year driven by the continuing itanium pressures. This business now comprises just 4% of segment revenue and is expected to continue to face growth challenges. Phase 2 of the Oracle itanium trial is currently scheduled to begin in the second quarter. It is important that the trial proceed to Phase 2, to address Oracle's breach of contract and the damages and or other remedies HP is entitled to receive.

Networking revenue was up 4% year over year at $608 million, and up 6% when normalized for a divestiture in Q1 of 2012. This business has seen sustained growth momentum and we're taking share. We continue to work on channel engagements and sales productivity, and this is one of the few businesses where we saw growth in EMEA. We are disrupting the market, being the first vendor with a full software defined networking solution with a complete ecosystem offering. Technology Services revenue was down 1% year over year to $2.2 billion. Again, this business is now being reported in the Enterprise group segment because of its key relationship to the hardware businesses. As we continue to align go-to-market capabilities and expand penetration rates across Support and Services, we expect that this important business, with some of the best margins in HP, will benefit.

The new reporting segment Enterprise Services delivered revenue of $5.9 billion, down 7% from the prior year. Operating profit was $76 million, or 1.3% of revenue, down 1 point from the prior year. Some of the expected key account runoffs did not occur in Q1 as expected given customer decisions to delay until later in the year. We have increased our management discipline in resource management and are making progress in improving the financial impact of our low performing accounts. IT Outsourcing revenue of $3.7 billion was down 6% year over year, driven by contractual revenue runoffs and pricing pressures. Application and Business services revenue was down 9% versus the prior year at $2.2 billion, and we saw signing pressure in the quarter. Some of the larger account runoffs impacted revenue here as well.

However, we saw sequential double-digit growth in our strategic Enterprise Services revenue, such as cloud, security, application modernization, and information management. We continue to attack the market opportunity in this space. Software revenue of $926 million was down 2% from the prior year. License revenue growth was weak this quarter, down 16% year over year. Services revenue was down 8%, and Support revenue up 11% year over year. We continue to see growth in SAS bookings and revenue. Overall first quarter operating profit for Software was $157 million, or 17% of revenue. To understand the Software results you need to appreciate the focus we are applying to create a healthier, more profitable business.

For example, in Professional Services, we have moved away from unprofitable contracts and have also expanded the Professional Services ecosystems to our channel partners, improving our channel engagement while also expanding serviceability for customers. We are seeing broader market declines in our traditional IT Suite business and we need to stem the decline in licenses by better aligning the organization from an end-to-end perspective, improving our sales productivity, and shifting more of our business to SAS. We saw strong growth in both our Security and our Big Data software offerings. We are excited about the healthy pipelines across Security and Big Data, and along with Autonomy, cloud, and the IT Performance Suite, these key strategic pillars are leading the integration of Software with the broader HP portfolio. The integration can be seen in new product innovations across PPS, EG, and ES.

HP Financial Services revenue was up 1% year over year at $957 million. Financing volume was down 25%, and net portfolio assets increased 1% year over year to $12.6 billion. Operating profit of $101 million was up 100 basis points to 10.6% of revenue.

Now on to capital allocations and the balance sheet. Operating cash flow was $2.6 billion, up 115% year over year and free cash flow was $2.1 billion, up over 400%. Total gross cash at the end of the quarter was $13.1 billion. This was a strong quarterly performance for us in what is normally a seasonally weaker cash flow quarter. At a security analyst meeting in October, we described a potential deposit up of to $400 million to the India Directorate of Revenue Intelligence relating to a legal dispute about customs duties. The amount of that deposit has now been determined to be $34 million, $10 million of which was deposited in Q1. HP is required to deposit the additional $24 million in March.

We continued to manage working capital well in the quarter. The cash conversion cycle was 23 days, down five days year over year. all of the improvement was in day sales outstanding and days of inventory. Our cash conversion cycle increased two days quarter on quarter, in line with normal seasonality. During the quarter, we returned $253 million in cash to shareholders via share repurchases, leaving roughly $8.9 billion remaining in the authorized share repurchase program. We also paid $258 million to shareholders through our quarterly dividend.

Our net debt at the operating company level now stands at $4.7 billion. We improved this position over $1.1 billion this quarter. Here, too, we are seeing steady progress.

Now turning to our outlook. As we have said before, fiscal '13 is a fix and rebuild year for HP. While we have seen positive signs in our Business performance in Q1, there are macro and market pressures that we continue to face, and some of the ES headwinds we expected in Q1 have just been delayed until later this year as customers work through those complex transition. We still expect the runoff to occur with the major profitability impacts more likely to occur in the second half. The investments we are making across IT systems, supply chain, new product innovations, and cloud are starting to bear fruit. But there are key challenges still out there.

Frankly, the business deterioration we are seeing in Personal Systems, particularly in EMEA and with notebooks, is worse than we expected. For Q2, we expect the rate of year-over-year revenue decline within Personal Systems to increase from Q1, especially given that in Q2 of 2012 we were benefiting from the rebound after the hard disk drive shortage the previous quarter. Our Server business has a particularly strong market position in EMEA, and the economic backdrop of that environment is still dismal. The itanium challenges within BCS are also still with us. Within Storage, we are getting close to the point where the converged storage growth will outpace the declines from the other external disk products. Networking should continue to deliver as it has been. We expect that currency will be a headwind to revenue of approximately 1 point year over year in Q2.

With that context we continue to expect full-year fiscal 2013's non-GAAP earnings per share to be in the range of $3.40 to $3.60. For fiscal 2013 Q2 we expect non-GAAP earnings per share in the range of $0.80 to $0.82. From a GAAP perspective, we expect a full year GAAP earnings per share to be in the range of $2.30 to $2.50. GAAP earnings per share for fiscal Q2 is expected to be in the range of $0.38 to $0.40. With that, let us now open it up for questions.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

Bill Shope, Goldman Sachs.

**Bill Shope** - *Goldman Sachs - Analyst*

Okay, thank you. There's been an increase in press and speculation regarding the potential benefits of a breakup, or more significant restructuring of the Company. Can you review how you think about the long-term benefits of HP's current structure, and are you still committed to turning around HP while keeping the core divisions together?

**Meg Whitman** - *Hewlett-Packard Co - CEO*

Yes, I'll take that question. So, we have no plans to break up the Company. And I've said many times, I feel quite strongly that we are better and stronger together. HP over the last 10 years, I think, has put together the most valuable franchise in IT, particularly as we look forward to the most significant change in how IT is bought, paid for, consumed, how applications are going to have to be made more agile. We have a terrific set of assets, and we're going to drive that to, I think, really great business performance. Over time, the business performance has to under score the value of better together. When you think about our brand, our scale, our distribution, our go to market, collaboration on R&D and supply chain, I think we've got a great set of assets. Importantly, customers want this Company to be together. We heard that loud and clear in August 18, 2011. We really feel strongly that this is better together.

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Great. Thanks, Bill Next question, please.

**Operator**

Katie Huberty, Morgan Stanley

**Katie Huberty** - *Morgan Stanley - Analyst*

Thanks, good afternoon. The better first quarter results and better than expected second quarter guidance suggests that earnings in the back half of the year will come down. Just curious, what has changed in you mind? You mentioned greater PC weakness, back-end loaded impacts from the run off of services deals. What else makes you more cautious on the back half of the year?

**Meg Whitman** - *Hewlett-Packard Co - CEO*

You know, Katie, I think you captured the main reasons for the comments about the back half. I mean it really is about the fact that ES didn't have the run offs that we had expected in the first quarter and that that has pushed out. It's also true that I would say in the first quarter signings in ES were not quite what we wanted them to be, or had expected them to be. As you know, signings earlier in the year mean revenue late in the year, and if the signings come in later in the year then that means revenue for 2014. So that's a little bit of a challenge that we've got to overcome, and that's about making the right investments. They're looking at putting that in place. It's about getting the right sales leader in place, and we've got Larry stack who has joined us.

I think there's some cautious optimism there, but the first quarter signings were a little weaker than we thought. Personal Systems business, the market was weaker than we had expected and we really saw in that EMEA and across notebooks. So, we're really not expecting that the market improves in fiscal '13 at this point. As I mentioned in my prepared remarks, we do expect that the Personal Systems revenue will decline year over year at a faster rate than it did in the first quarter. We're going have to have to watch that very carefully.

Then finally, we did delay some enabling investments and I would say that was probably due to our cautious nature of wanting to see the savings before we go and make some of these investments. Now we're starting to ramp some of those investments that we had decided to delay, and those were investments mostly in enabling savings over the long term, things like some of the IT stuff, some of the site consolidation in the real estate area, and so we're basically laying those out going forward.

**Katie Huberty** - *Morgan Stanley - Analyst*

Thank you.

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Thanks, Katie. Next question, please.

**Operator**

Tony Sacconoghi, Sanford Bernstein.

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

Yes, thank you. I'm wondering if you can update us where you are in your cost savings initiatives? I think you had outlined previously that you expected labor savings to amount to $2.2 billion in gross savings and non labor savings to be about half of that amount, so a total of $3.3 billion. Can you tell us, and I realize there's some reinvestment there, but can you tell us on a gross basis what you think you captured on a run rate basis in fiscal Q1 and where you think you are in that process?

**Meg Whitman** - *Hewlett-Packard Co - CEO*

Yes, Tony, this is Meg. Let me give you sort of a high level comment on this, then I will ask Cathie to be more detailed. This restructuring program is an incredibly important part of our strategy, because we have to create the financial capacity to invest and then to grow. I would say the restructuring program remains very much on track. A further 3,500 people left the Company in Q1 of this year, and the FY '12 headcount reduction was 11,800. So we've now asked 15,300 people to leave the Company. While that is a very tough thing to do, we can actually see savings from that and we can actually see a more streamlined and focused organization.

We expect the savings to ramp through the remainder of '13 and into '14. This is the financial capacity that we're going to need to hit our numbers and also create the financial capacity to invest.

**Cathie Lesjak** - *Hewlett-Packard Co - CFO*

I think the only thing that I would add is on the non labor savings, the bulk of those savings are really coming in, in the second half of the year. In fact, in some cases, we've needed to make enabling investments early in the year in order to realize them. We believe that we're still on track to make those savings.

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Great. Thanks, Tony. Next question, please.

**Operator**

Ben Reitzes, Barclays.

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

Yes, thanks a lot. Meg and Cathie, I understand why you want to keep the guidance for EPS, because PCs could get worse and the Europe uncertainty, but why not raise the free cash flow target of $5 billion, given the first quarter was better than expected on the free cash flow front? And what are the puts and takes there of that number? What are the chances that could be actually $6 billion or higher as we go throughout the year?

**Meg Whitman** - *Hewlett-Packard Co - CEO*

Thanks, Ben. I'm glad you pointed out the operating cash flow. We're very pleased with the progress that we made with respect to operating cash flow, up 115% year over year. Then the other key piece is that we've really gotten the discipline around capital expenditures, and that enabled to us grow our free cash flow over 400% year over year to $2.1 billion. Now, we don't typically update our cash flow outlook mid year. And so I'm not going to update it, but I think the best way to think about the first quarter was it was a very big deposit on the year. There is also the fact that the DRI deposit that we had originally expected was -- could be up to $400 million, came in lighter, and I think this also gives us bit is a tailwind.

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Great. Thanks very much, Ben. Next question, please.

**Operator**

Shannon Cross, Cross Research.

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

Thank you very much. I was curious how you're going to be judging the success of the Officejet Pro X platform. Sort of what benchmarks should we look at and how should we think about the potential margin contribution? And then also, how are you thinking about this launch vis-a-vis your laser line, which you obviously get from Canon? Thank you.

**Meg Whitman** - *Hewlett-Packard Co - CEO*

Yes, so we're excited about the Officejet Pro X. I'm sure you've read, it's gotten terrific reviews from the industry trade magazines as well as customers who have had some early units. This is an exciting opportunity because basically what this does is allow ink to move up into small to medium size, even to some pretty big businesses, because effectively it prints exactly the same speed and quality as laser at half the cost. This is the kind of disruptive innovations that we do at HP. This has been worked on for a number of years at HP. This PageWide array technology is breakthrough. We're going drive it as hard as we can. We're going to measure ourselves by the number of units installed over the next 12 months and what kind of customers adopt it.

With regard to laser, listen, we've got a great laser lineup, but to the extent that there is cannibalization, that's the natural order of things. I've said for many years, when there's disruptive technology innovation in a business, better to do it to ourselves than have someone do it to us. Of course, ink is margin accretive to us because we obviously own all of that IP. Cathie, do you want to add anything?

**Cathie Lesjak** - *Hewlett-Packard Co - CFO*

I think the only thing else I'd add is, take you back to the security analyst meeting, we believe that even with our Ink in the Office products encroaching a bit on the low end of the laser, that we still have an opportunity to grow the laser business from a revenue perspective, and to take share. So I think that that -- it's not -- for us, it's not one or the other. We are basically executing in both business domains.

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

Thank you.





THOMSON REUTERS

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Great. Thanks, Shannon. Next question, please.

---

**Operator**

Brian Alexander, Raymond James.

---

**Brian Alexander** - *Raymond James & Associates - Analyst*

Thanks. Just on the Personal Systems business, I think your original outlook for the year assumed flat profits. We just saw revenue down 8%, profits down 50%. Obviously, it's a tough market. But, Meg, you sound very committed to staying in the business, and you sound pretty excited about the new products that you're launching. So how are you thinking about the financial profile of this Business going forward given your comments about balancing growth and profitability and given where your margins are versus where they have been historically?

---

**Meg Whitman** - *Hewlett-Packard Co - CEO*

We are committed to this business. As I said, we're going to compete on differentiation, whether that is form factors, an increased focus on mobility, a multi OS strategy, multi chip strategy. Frankly, relevance to various industries. We've got great response to our LeapPad 900 that can be customized by industry. And then Services. So, the way we've got to handle this is that we have to reallocate resources from the core PC business to mobile to other OS and to Services.

So while we have to make some investments, it can't be incremental investments, it's got to be moving resources from one part of the business to the other. We've got to continue to focus on operational excellence. We've made progress there, whether it's SKU reductions, platform reductions, supply chain, quality. This, by the way, has actually been pretty helpful in terms of when we've combined our printing business with our PC business because we've been able to leverage nodes, logistics, transportation. So I think, listen, we anticipate that pricing is going to be problematic and quite competitive in the next bit of time here. But we think we can manage that, and I think we see quite clearly what this is going to look like.

---

**Cathie Lesjak** - *Hewlett-Packard Co - CFO*

Let me also add that if you look at the year-over-year operating margin declines, that was really driven by currency, the weak demand environment, combined with aggressive pricing. As we look out over the rest of the year, our expectation is a weak demand environment and the aggressive pricing stays with us. So, it's really facing a tough and shrinking PC market, broad softness in the PC market, but especially in notebooks and in EMEA. It's more challenging than we had expected. So, I do -- we do expect now that on a year-over-year basis, margins will erode. A little bit different expectation than what we said at the security analyst meeting. We expect weak consumer demand and aggressive price competition to remain a headwind throughout most of '13. Then finally, I think it's really important to understand the impact or lack of impact this business can have on HP's P&L. Just to remind you, that the $223 million of operating profit from PSG is just 10% of the Company's operating profit.

---

**Brian Alexander** - *Raymond James & Associates - Analyst*

Okay. Thank you.

---

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Great. Thanks, Brian. Next question, please.

---

**Operator**

Keith Bachman, Bank of Montreal.

---

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

Hi, thank you. I'd like to ask about Enterprise Systems profitability, please. The profit levels, even under the new reporting format, have been down for nine straight quarters. Why do those margins stabilize, or if you can give us some update on why the Business may stabilize in terms of the margin profile? And particularly address, if you can, where you think mix actually starts to stabilize or improve? Thank you.

---

**Meg Whitman** - *Hewlett-Packard Co - CEO*

Yes. So there's a number of different factors going on in EG, Brian, and the negative ones --

---

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

Hey, I'm Keith, not Brian.

---

**Meg Whitman** - *Hewlett-Packard Co - CEO*

Oh, Keith, sorry about that. Sorry, Keith. The negative factors, of course, is the continued decline of BCS. It was a big and profitable business. You saw it decline 24% year over year. Traditional storage is declining. EMEA we have an over developed share. Not over developed, but a very robust share in EMEA, and when that market is weak it disproportionately affects Hewlett-Packard.

But the good news is, we are -- have got, I think, the best product lineup we've had in a long time here. And we are making investments behind that product lineup. R&D is the life blood of this business. As we migrate from traditional storage to converged storage, as we continue to gain share in networking and SDN, as cloud system continues to lead the way in terms of private clouds, we have nearly 1,000 private clouds up now in installation, and as we continue to focus on excellence in operations and TF attach, I think over time we will see those margins start to turn. But we have to make the necessary investments, because this business is now a big chunk of the profitability of Hewlett-Packard. It's a big strategy going forward us, so we want to make sure that we lay the ground work for profitable growth in 2014.

---

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

Meg, just to push you, sorry, can they hold at these levels for the next couple quarters? Due think there's more down side?

---

**Cathie Lesjak** - *Hewlett-Packard Co - CFO*

I don't -- we're not really calling for more down side. We definitely need to get the growth areas of this business, Networking and Storage, growing again, and that's clearly the Converged Storage solutions growing 18% year over year. Those need to grow faster than the declines in the traditional and we're getting close to the point where those will cross over. That's going to help us on the Storage side. Networking did very well this quarter. We expect it to gain share. It was up 4% year over year. When you normalize for the divestiture that we did a year ago, it's up 6%.

We're very pleased with the Networking performance, and believe that this -- for Enterprise group, it's going to be all about differentiation. We're not conceding commoditization anywhere. We're investing to differentiate kind of value propositions for our customers and that's Moonshot. That's software defined Networking. That's the mid range 3PAR product combined with some Autonomy software. I mean, there's just some real opportunities here for a differentiated experience.

**Meg Whitman** - *Hewlett-Packard Co - CEO*

I'd say one last thing, Keith, is a big chunk of our go to market is with the channels. And we have made a big investment in righting the relationship that EG has with the channels. We just came back from our Global Partner Conference in Las Vegas. I can tell you first hand, we're making really good progress, here. So if revenues grows, obviously we leverage the fixed cost of the Business and that will help margins, too.

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

Okay. Thanks, team.

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Thanks, Keith. Next question, please.

**Operator**

Mark Moskowitz, JPMorgan.

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

Yes, thanks, good afternoon. Meg or Cathie, clearly it's still early, but your net debt position is improving nicely, free cash flow, as you talked about earlier, had a really big improvement. Just want to get a sense in terms of update, in terms of how you're thinking about either investment internally from an R&D perspective and/or maybe a renewed appetite for bolt-on acquisition? Has your acquisition strategy changed in light of your improving business model?

**Meg Whitman** - *Hewlett-Packard Co - CEO*

I'd say for 2013, our capital allocation strategy isn't going to change. We're still focused on rebuilding the balance sheet, offsetting dilution, maintaining our dividend policy, and really focus on fixing what we have. The leverage in fixing and rebuilding the assets that this Company has put together over the last 10 years is simply enormous. Now, you never say never. Maybe there's a tuck-in acquisition that we absolutely have to have to further converge cloud, but it's not in the plans. And then, with regard to R&D, we've got a plan for R&D. One of the things we have to stop doing at HP is increasing R&D and then pulling it back. Increasing R&D, and pulling it back. So we've got an R&D plan, we're sticking to it. The initiatives are pretty well laid out for the next 12 months.

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Great. Thanks, Mark. Next question, please.

**Operator**

Brian Marshal, ISI Group.

**Brian Marshall** - *ISI Group - Analyst*

Thanks, guys. Question with respect to Software. Obviously it's a real key component to increasing the Company's competitiveness going forward and at only down 2% year over year was your best performing major segment. But, if you delve a little deeper and just make the simple assumption that Autonomy, perhaps, was down 25% from where you guys acquired it, that would imply that your core software business is probably running something like mid single-digit growth year over year. That's a pretty marked deceleration from what we've seen recently. I guess the question is, do you think that deceleration of growth is going to continue in your core software business? And if not, why should we anticipate that turns around? Thanks.

---

**Meg Whitman** - *Hewlett-Packard Co - CEO*

Thanks, Brian. So our Software business, the bright spots there, as I mentioned in my prepared remarks, are Vertica and Security. These are very robust businesses. We've got a great pipe. Things are going very well. Apps and ops, our license revenue, was not where we wanted it to be. My belief is that that's a couple things. One is execution. Two is sales leadership. Three is some changes that we need to make to the product. I think we will actually turn that revenue trajectory around as we go through 2013 and enter into 2014, but we've got some basic blocking and tackling work that needs to be done in that part of the business.

---

**Brian Marshall** - *ISI Group - Analyst*

Thanks.

---

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Great. Thanks, Brian. We've got time for a couple more questions. We'll run just a little long to squeeze a couple more in. So, next question, please.

---

**Operator**

Steve Milunovich, UBS.

---

**Steve Milunovich** - *UBS - Analyst*

Great, thank you. Cathie, you mentioned a bit about the inventory situation with printer supplies. Could you talk about PCs and any other products that you track in terms of weeks of inventory?

---

**Cathie Lesjak** - *Hewlett-Packard Co - CFO*

Sure. Overall our channel inventory across EG, printers, and PCs were all within acceptable ranges. We feel very comfortable with where we ended on channel inventory. Specifically, with respect to PCs, overall, it's good. I would say that on the consumer side, despite the fact that we gained share in consumer, we ended channel inventory a bit higher than we would like. We are clearly focused on bringing that down a bit in Q2. But I think the real star here is the channel inventory performance in IPG. We have been dogged by ink supplies channel inventory being higher than we would like now for several quarters, and it is now well within the range. I think it's something like, from the peak, something like 27% down year over year. So it's just -- I'm sorry, 27% down since the peak. I think that's really strong. We've had dollar declines over the last six quarters. So, it's all in good shape at this point.

---

**Meg Whitman** - *Hewlett-Packard Co - CEO*

I would just add, this is Meg, one of the things we have asked the business groups to do is to limit the discounting to get product into the channels. Because in the end, we have to discount to get the product out, and so we have turned our sales force compensation to sell through as opposed to sell in. This is healthier for us. It's better for the channel, and I think it's put us in a much better position. It also allows us to continue to differentiate our ink and toner product by substituting what we call contra revenue, or discounts to marketing, where we can actually differentiate our product as opposed to be on the road to commoditization that I think we were on about 18 months ago.

---

**Cathie Lesjak** - *Hewlett-Packard Co - CFO*

And frankly, that's helping to drive some of the average selling price increases across PCs and Printers.

---

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Great. Thanks, Steve. Next question, please.

---

**Operator**

Amit Daryanani, RBC Capital Markets.

---

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

Thanks a lot, guys. Just a question around the Enterprise side. One on the Storage side. Can you maybe just talk about, when you look at the Converged Storage revenues up 18% year over year, how much do you think was from cannibalization of the legacy EVS solutions if you may versus the new customer acquisitions? I don't know if you can break that down, but that would be helpful. Just on Moonshot as well, when do you start to see that becoming a material contributor to the RSS revenue stream? That's about it. Thank you.

---

**Meg Whitman** - *Hewlett-Packard Co - CEO*

On the Converged Storage, we have put a real emphasis on Converged Storage. We want to sell the new stuff, the stuff that is disruptive in the marketplace. So our sales executives are all about 3PAR, high tier, mid tier, StoreOnce, what used to be called left-hand networks, and I-bricks. I don't know how much is cannibalization versus a real focus, because my belief is sales teams can sell only so many things. We have told them we really want to be in the product that's disruptive. Moonshot grows through the year. We're just taking our first orders now for first phase of Moonshot. We're excited about it because of the characteristics of that technology. You might not be surprised to know that our first Moonshot order came from Japan. And the reason, of course is that they lost a big chunk of their grid in the tsunami, and so space, energy savings, and compute value at cost levels that are unprecedented. We're excited about this. So, it will build through the year. Frankly, it won't hit its real, I think, full potential until 2014.

---

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

Perfect. Thank you.

---

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Thanks, Amit. I think we've probably got time for one last question.

**Operator**

Kulbinder Garcha, Credit Suisse.

**Kulbinder Garcha** - *Credit Suisse - Analyst*

Thanks. A question for Meg and Cathie. Just going back to free cash flow, I understand you don't want to update this year's guidance but given the improvement you would expect in free cash flow for the year, if looks like you're going to pay down most of your debt, probably in side of 12 months. If that's the case, and HP are in the situation you're generating $6 billion, $7 billion of free cash flow a year, can you remind us how committed you are to increasing dividends and buybacks? Thanks.

**Cathie Lesjak** - *Hewlett-Packard Co - CFO*

So, I think you're right. I think we've made a good deposit on bringing our net debt at the operating company level down to zero. I would expect that, while originally we thought it might take us until the end of '14, that it probably won't take us quite that long. And then we'll be back in looking at our capital allocation priorities that we laid out, how we think about capital at the security analyst meeting. Then it's really about what kinds of returns do we get for what different types of investments, and basically going to the highest and best return. We do -- we are committed to returning cash to shareholders, and we do think that that takes the form of both share repurchases and dividends. Our view around dividends is that over the long term, as our operating results scale, our payout ratio should probably scale as well. Obviously, we stay in touch with our Board because ultimately that's their decision. We are aligned and working with them to determine what will be the right set -- the right mix of returning cash to shareholders over the long term.

**Meg Whitman** - *Hewlett-Packard Co - CEO*

Good. I think that is the last -- time that we have for the last question. I thought I might just make a couple of closing remarks. If I can leave you with three thoughts. First is, the turnaround is on track and we did better than we expected that we would. So, I think that's a good sign. I said is it in my prepared remarks. The patient showed some signs of improvement and I think we should be encouraged by that. We have three more quarters to go in this year. We feel very confident about delivering the full-year results, but we have to deliver. We have to continue to execute as an organization. So thank you very much. I think we'll end the call now.

**Rob Binns** - *Hewlett-Packard Co - VP IR*

Yes. Thanks very much. That concludes the call. Thank you, everybody.

**Operator**

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