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PRESENTATION

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Good afternoon, everyone. I'm Toni Sacconaghi, Bernstein's US IT hardware analyst and I am very excited that HP's President and Chief Executive Officer, Meg Whitman, is joining us today. Meg has been President and CEO of HP since September 2011 and was a Board member of HP since January of that same year.

As you will note up on the screen, HP has its forward-looking statements. I would direct those to you in advance of our discussion.

Meg has kindly agreed to do a fireside chat during our period. I will be leading that. Would certainly love to take questions from the group. If you do have questions, please feel free to put them on cards in your seats and pass them to the center aisle and those will be brought up.

So without further ado, Meg, maybe we can punch in.

Meg Whitman - *Hewlett-Packard - President and CEO*

That's great. Happy to be here.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Welcome and thank you. You have been CEO for a little over a year and a half now. Maybe you could share with us what you have learned about HP as a CEO. You were on the Board before, so clearly involved with the Company. But what you have learned in your role as a CEO that has surprised you and has your view of HP's strengths and weaknesses changed at all since you have become the CEO?

Meg Whitman - *Hewlett-Packard - President and CEO*

I would say obviously, now having been the CEO for 18 months I know a lot more about the Company than I did as a Board member and I have been a Board member for about six months before I took over. I would say the strength that I think are well known about HP but I deeply appreciate are really the following.

The first is at our core we are an engineering company that engineering expertise, commitment to great product, great software, great services is very much a part of the HP DNA. And one of the things we did was unlock that passion for R&D for great product by increasing our R&D budget and focusing people on a smaller number of initiatives.

I would say the second great strength of this Company is a passion for customers and customer support. We will do anything for customers, sometimes at great cost. But deep in the DNA of this Company is the passion for customers.

And I would also say the talent at HP is remarkable and you might have expected a brain drain over the CEO transitions over the last couple of years and I am sure there are some talented people who left. But I will tell you that is not a major challenge for us in terms of the quality of the workforce, the quality of engineers, the quality of the sales team.

I think the challenges that we face are clearer to me than they were, obviously, when I started and we are spearheading a turnaround during some of the most tumultuous times, at least in my history in IT. And so we face these huge tectonic plate shifts in terms of IT, how technology is bought, how it is sold, how it is paid for, how end-users relate to that technology, how software is sold and serviced. So we have these big industry shifts to contend with.

We have a macroeconomic environment that isn't helping us. I don't think we're going to get headwinds anymore -- I don't think we will get tailwinds from the macroeconomic environment for the remainder of '13 and '14.

And then lastly, there is a host of HP specific issues that we have to contend with, whether it is our investments in IT, how we were organized, how simple we are or are not to do business, the relationship that we have with the channel. There is a lot of what I would call executional issues that I didn't have a complete appreciation for when I came on as the CEO. The good news about that is those are -- it doesn't take a brain surgeon to fix those. It is basic blocking and tackling, but it does take some time.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Meg, I was wondering if I could follow up. The joy of doing a fireside chat is I can ask unlimited follow-up questions, which is a terrific thing.

You talked a little bit about the turnover and the lack of a brain drain. Do you measure that in terms of either top executives or for the workforce as a whole in terms of turnover? I don't know if you can share absolute numbers or relative numbers versus history, but that is something -- a question that I receive a lot. So maybe you could comment on that and then I had one other follow-up to your opening response.

Meg Whitman - *Hewlett-Packard - President and CEO*

Sure. So we look at the metric that we follow is undesired turnover, people who leave at the VP level and above who we wish we hadn't. And that number has actually stayed remarkably stable since the day I took over. As I looked back, actually over the year and a half or so before that, it had been slightly higher, but the turnover I think is greatly overstated by the media and others. We have actually a stable group of executives and so most of the people that we have lost are people that we actually asked to go.

It is in line --- I don't think we have publicly stated that, but it is in line with other big companies that I have worked with. And it is very interesting, morale at HP is driven by how well I think the Company's strategy and passion for our business, how well understood that is by our employees and it's very interesting. Someone said to me the other day when the stock was at \$14 a share or something, they said listen, we are happier today when the stock is at \$14 a share than when it was at \$45 because we have faith in what we are doing together. And we wish the stock was higher, and obviously today it is, but this is a group of people that are motivated by mission more than many companies I have seen.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

The other thing that was interesting that you mentioned is you didn't really expect a macroeconomic tailwind in '13 or in '14, and I have certainly heard you say '13. I am not sure if I have heard you say '14 and how purposeful a statement that was. Maybe you can talk a little bit about what you think is going on right now in terms of IT spend and then more broadly, what do you think is a normalized level of IT spend?

There are lots of -- there is a lot of speculation that we are in a uniquely deflationary period that is prolonged and secular. So perhaps you can comment explicitly on your '13 and '14 comments, and then if we step back more steady-state, how do you think around IT spend relative to GDP or versus history?



Meg Whitman - *Hewlett-Packard - President and CEO*

Yes, well I will make a couple of comments. I think that the financial crisis of 2008 fundamentally reset not only consumer spending but also business spending on categories like IT. If you look at large financial institutions, their compliance costs have gone up dramatically and that money has to come from someplace. We see businesses of all sizes fundamentally having reset how much they are willing to spend and I think that is a function of the financial crisis and sort of the confidence around are we really out of the woods yet?

On the consumer side, we see that in spades. Look at the pricing pressure on the Personal Systems business. There is, I think, a fundamental reset of what consumers are willing to pay for. So we are not bullish in that regard.

If you look at Europe, we find Europe to be a reasonably difficult environment. Some months it gets better and then some months it gets worse, but that is not -- I don't think it is going to be a growth story in 2014.

The United States continues to sort of bump along. We don't see it getting meaningfully better. And then China is a bit to some degree, like Europe. China feels strong and then the growth starts to slow and we will often see the government make some changes to stimulate that growth rate and then it slows again. And we saw China slow to some degree in the last quarter.

So that is the way we think about it. In terms of long-term spending, I read your note on long-term GDP growth rates and the relationship between IT spending and GDP growth. I thought it was really well done, and --

Toni Sacconaghi - *Sanford Bernstein - Analyst*

This was not a plug.

Meg Whitman - *Hewlett-Packard - President and CEO*

But he is impressed I read his notes. I thought that sort of notion of just 3.8% growth in IT spend seemed about right to me. It varies by industry. Healthcare spending more, CPG is spending a little less. Financial services is spending less, but I generally agreed with the relationship that you cited between GDP growth rate and IT spend.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Okay. Meg, you have been very deliberate and purposeful in talking about HP being on a four or five year journey and articulated that fiscal '13 was really a fixed and rebuild year and that I think '14 would be a year of recovery and expansion.

Now, I think one of the other things that you have done, people often ask me about, well, how would you characterize what HP's guidance? And I say, well look, they don't say a lot but they are pretty committed to what they say. I think those are words that you have used.

And so last year you said \$4. You eclipsed that. This year you said \$3.50 and you reiterated that and in fact, gone a little bit higher on your range. For next year, you had said that HP would grow. And I guess the question is is that still realistic given the macro environment that we talked about?

And a pretty tough growth rate in the first two quarters of this year, I think down 8.5% or so for the Company in the first half. So is fiscal '14 -- is growth -- top-line growth in fiscal '14 realistic at this point?

Meg Whitman - *Hewlett-Packard - President and CEO*

Yes, so I believe that top-line growth is still possible in 2014. What we are managing is a set of declining businesses, businesses that I would characterize as supporting the old style of IT and then we are -- have a number of growth engines that are growing quite fast. But in order for us



to grow in 2014, those growth engines need to become bigger than the businesses that are declining. And what I think happened to HP is in the technology business there are very quite predictable lifecycles of products and in the CEO transition, I think we let some of these products go too long on the downside before we had the next generation of those products. So we needed acorns to be planted before we had to have oak trees and we were late I think as HP in planting those acorns and so we are playing catch-up.

So I think the real question about 2014 is from a revenue perspective is how dramatic is the continued decline in PC growth? What happens in some of our other businesses? And I will give you a microcosm of this which is our storage business.

So we have a traditional storage business that is declining, that is [Tape] and a number of other traditional storage businesses and then we have our growth engine which is 3PAR and StoreOnce. Our converged storage product is 3PAR grew at 82% year over year. Unfortunately, Tape and some of those older businesses are declining quite rapidly so we're managing that declining business versus the accelerating business.

And so the long answer, and I am being a little bit more long-winded than I want to be here is the question is how fast are the declining businesses declining? And what I see now is I think we will be able to grow. Maybe not a huge amount in 2014 but I think we will be able to grow top-line growth.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Yes, I mean I just -- I think about -- I think for this year my forecast is probably minus 7% growth and if you don't get that macroeconomic tailwind -- I just wonder if there really can be enough of a shift in that portfolio for ultimately the math to work.

Let's say we get to the end of the year or early in fiscal '14, and revenue growth doesn't appear likely. How important is that? Because on one hand you could say well, if the Company is still generating improving earnings, that is good. On the other hand, you have often talked about accountability, we're going to do what we say, etc. etc. So how hard and fast is revenue ambition for next year? If it looks less likely at some point later this year or early next year, is there an alternative course or plan that you see the Company in?

Meg Whitman - *Hewlett-Packard - President and CEO*

Sure, sure. Well first of all, you said it correctly that we are committed to EPS growth, no question about that. And we have a very clear view to that given our restructuring, given how much more efficient and effective we have become at running this Company. And by the way, we are not scrimping on the investments that we need to make to set this Company up for the long term. But I feel very, very confident on an EPS growth acceleration for sure.

The revenue side, listen, the way the numbers look to me today I feel confident that we will have revenue acceleration. If we don't it will be because, for example, the PC business continued to decline more dramatically than we are forecasting or anyone else is forecasting. The traditional storage decline accelerates even more aggressively.

So, I would say, listen, if we are within striking distance of a bit of growth, I don't think we would change course. If we forecast that we are going to perhaps decline by another 10% or 15% next year, then I think we have to rethink the strategy.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

What are the degrees of freedom or limitations if you did have to rethink? People have sort of -- these are questions I was going to ask you later, but I think they go further. You guys have done a terrific job on cash and balance sheet improvement so you will actually have the luxury of a strong ongoing cash flow with operationally speaking a debt-free company going forward.



So to the degrees of freedom on a go-forward basis, whether it is because results are more disappointing or just as an operator who has those degree to freeze them, is a large acquisition possible once the balance sheet is restored? Is that a degree of freedom that you will use at your discretion?

You have sort of said you won't use it until the balance sheet is restored, but once it is, is that one that you would use? You have also talked about this Company is better kept intact than in its parts and how sacrosanct is that in the near to medium term as well?

Meg Whitman - *Hewlett-Packard - President and CEO*

Yes, yes, so we will be in the happy position of having now some choices to make around capital allocations. As most of you know, our capital allocation strategy was offset dilution through share buyback, increase our dividend slightly and then pay down debt and a lot of you had questions about that. I remember when I met with many of you and you've asked me that question, was that the right strategy?

Listen, I feel very good about our operating company net debt position by the end of the year, and now we have to decide how much share repurchase, what do we want to do about dividends and do we want to make acquisitions? I would not view making acquisitions as a solve to the revenue growth problem. That I would not do. I wouldn't make an acquisition just to be able to say that I could grow in 2014. That makes no sense.

And my view on acquisitions is they will be smaller tuck-in acquisitions that fundamentally change our position perhaps in converged cloud or other areas that we are making big bets in, whether that is cloud or security, big data or mobility. That would be the kind of thing we would do but we would never make an acquisition just to say we could grow in 2014.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

And on the keeping the Company intact?

Meg Whitman - *Hewlett-Packard - President and CEO*

The keeping together, yes. So listen, we thought a lot about this, and say what you will about my predecessors, they assembled a set of assets here that just happen to be perfect for what I call the new style of IT. So whether it is ArcSight, TippingPoint and Fortify, EDS, while we took a write-down on EDS largely due to market cap reconciliation earlier in the year when our stock was so low, the actual asset is actually quite good and we've got a great leadership team that is leading a much more stable and vibrant Enterprise Services business then I inherited when I got here.

So I think these pieces fit together but I think as you have articulated, Toni, either we will make this group of assets sing together and be a differentiator for HP, in other words, our converged cloud offering is differentiated from every competitor because of the assets that we have. But we have to demonstrate that that is the case and I think you have been quite articulate that at least over time if we don't demonstrate that we are better together, there will obviously be activist shareholders or others who have a different point of view.

But I am committed to making the sum of the parts much for the whole, much greater than the sum of the parts, which as you know today is in fact probably not the case.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

And, Meg, and I appreciate your candor on that. You have articulated a five-year plan.

Meg Whitman - *Hewlett-Packard - President and CEO*

Yes.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Are there important milestones where you would assess that? I think it is too early after one year to say, oh, well, the whole is not working together. Let's get -- but are there either tangible milestones in terms of achieving the financial target or time milestones where you say, look, we have been kicking this can for X years and it is not delivering what I think where those things become more of a question. I mean I think for now as you have articulated well, this is let's stick to the plan and continue to move forward here.

But how do you think about that either in terms of -- what are the milestone posts that we should watch for in terms of your beginning to reassess that notion of togetherness versus doing something that might be more radical?

Meg Whitman - *Hewlett-Packard - President and CEO*

Yes, sure. So we did lay out a five-year turnaround plan and many people said, Meg, boy, that seems like a really long time. That will be somewhat disappointing to the investment community. Maybe it will even be disappointing to employees.

What I have said is I thought it was better to be realistic about the length of time that I thought it would take to get HP humming the way a Company like ours should hum. This is one of the largest companies in the world. It is an American global icon and it should be running better than it was when I arrived, and that will take some time. And we laid out last year was a diagnosis year. This year is section rebuild and next year we believe you will start to see revenue acceleration.

But we have also got to demonstrate that -- I will come back to converged cloud -- that we have a story that is compelling to not only our channel partners but also our end customers that we are better suited to help them on their journey to the cloud than any of our competitors. Every major customer is going to try to get from where they are with their existing technology to where they must be to maintain competitiveness in their industry.

I believe we have the very best set of assets and so we have to actually demonstrate that we are taking share in the journey to the cloud with our customers. We are widely recognized for being thought leaders there.

If you think about HP cloud services, which is our public cloud, that is built on OpenStack. We have jumped to the next technology. HP is now the second largest contributor to OpenStack. That is an important milestone in terms -- okay, how do these pieces add up to more than okay, you can buy private cloud from Hewlett-Packard. You can buy managed cloud services, you can buy our cloud system automation. So we have to demonstrate that across cloud, across security, across big data and, frankly, across mobility.

And then each of our businesses needs to perform up to their full potential. And so we have got to demonstrate that to our shareholders otherwise I think there will be a call for a lot of other actions but I feel confident in that.

Listen, HP people understand what they need to do. The customers want us to win. This has been one of the great amazing things to me that customers want Hewlett-Packard to win. Even if we have disappointed them in the past, they want us to win because the role that we play in the industry around innovation, around balance of power, around pricing competition, they want us to win. So we are getting the benefit of the doubt, which is an enormous help for our Company.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

I wanted to talk a little bit -- you had talked about some of the cost reduction activity and some of the reinvestments. I wanted to spend a minute on that.

So this year, I think the gross cost savings are about \$3 billion in total. That is about \$1.20 in EPS on the gross level. Now you guys at the Analyst Day I think had talked about a reinvestment level of about \$0.15 of EPS. I was wondering, A, can you talk about the things that you are reinvesting

in? That level dynamic results have been pretty good so far in terms of cash flow generation, etc. Has there been a change to that level and how you think about that?

Meg Whitman - *Hewlett-Packard - President and CEO*

So those cost savings -- and we are about halfway through our overall restructuring program, particularly on the labor side. There is a labor component and a nonlabor component. The nonlabor lags the labor component. But we are about halfway through where we want to be, right on schedule. Remember, we said this was a three-year restructuring program.

What we have used that restructuring program to do is, first of all, invest in the things that we need to set this Company up for the future. First and foremost is R&D. This has been a combination of focusing R&D and actually increasing the amount of dollars that we put against this. This is something that is absolutely critical to our future, so whether it is Moonshot or StoreOnce or our HP Networking, or our tablets, or whatever our next generation of printers, this is important for us.

I would say the second thing we are investing in is running HP more efficiently and effectively. We have made some pretty big investments in IT. The biggest recipient of that investment was Enterprise Services which was really running with very subpar to almost nonexistent IT. And when you have a business with 120,000 people and that is your only asset really in the business is those people and you don't know where they are or what their skill set is, and you can't put together a P&L for each and every one of your big 250 accounts, that is a big problem.

If you look at our HR systems, when you have a company with -- we started with 300,000 people, we are now down to about 275,000. If you don't know where those people are globally, what the talent level is, it is very hard to run this Company so we are moving to work day, off of an old antiquated HP HR system. We put our entire sales force off of Siebel Systems onto salesforce.com. This for the first time gives us a 360 degree view of customers and partners and it is a modern way to run a salesforce.

These investments were absolutely critical. We're making a lot of process investments. I think what happened in the past was we had processes and the first step was to take domestic labor and move it offshore. The bad news is we had bad processes that are now offshore, so it is a lower cost, but we have got to fix many of the business processes.

Quote to cash is an example that I use. We were behind our competition in the ability to deliver a quote in a short period of time for a config to order system. We are catching up. In fact, this week you will be able to do quote to cash in salesforce.com in front of the customer, which is a dream we have had for the last 12 months.

So those investments I believe will actually pay off to some degree this year but even more so, all that pipe we laid last year and this year you will really start to see a lot of that productivity, better processes, investments in how we run the Company, take hold next year. And it should show up not only in costs, Toni, but it should show up in revenue.

If we've got a better sales system and we could understand coverage better and we've got a 360 degree of the customer and our divisions are working together, whether we are at a partner or a big customer, that ought to show up in revenue which is why I have confidence that you will see revenue growth next year. But it has all got to work.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

On the cost side, do you think you are done? Let me provide the context of why I am asking that. I think peak revenue levels at fiscal '11 if I use that as peak level, this year I have you down about 13% relative to that peak level. And I think headcount reduction has been down about 9% and so one would just say, well, revenue is down 13%, headcount down 9%, do you need to do more to actually keep the costs current with revenue levels?



So is that an unfair way to look at it in terms of just looking at change in revenue and change in headcount? Should we expect more incremental cost cutting and, obviously, I would suspect if revenue was on your downside scenario for next year and didn't grow, how would we think about what needs to be done on the cost side beyond this major initiative that you have today.

Meg Whitman - *Hewlett-Packard - President and CEO*

Yes, so let me make a couple of comments there. One is, if you look at our net headcount reduction, what you see is we have cut deeper but then we have added back people into some of the investment areas. So we are focusing the headcount and the people on the areas that we want to invest in, which are those products and services and software that are the future as opposed to the past. We have been quite disciplined in the allocation of R&D dollars, the allocation of headcount, the allocation of IT spend to really focus on the future.

The second thing I would say is one of the things we set out to do was to get our cost structure in line with our revenue trajectory. After I had been here about three or four months, I foresaw the revenue decline that has actually come to pass and knew that we had to work on getting our cost structure in line and we are doing a good job there, but there is more to do. As I said, we're only halfway through this restructuring program.

And then the third thing we have to do with Hewlett-Packard is we have got to build productivity, cost continuous improvement in our cost structure into the DNA. I think one of the challenges that we have had with this multiple CEOs is -- you would know better than I -- how many restructurings has HP done in the last five years? Four or maybe five. And this is ridiculous and unsustainable. I mean cost-reduction needs to be part of the DNA. Productivity needs to be part of what you do as a company and it cannot be episodic around restructurings because guess who pays for the restructurings? You all do.

So this has to be part of our normal cadence and I think we've come a long way through dashboards and scorecards and productivity metrics that I think will set us up to be a much better run company.

I think you heard me say at the security analyst meeting that this company is not a -- was not a well instrumented company. I thought I would come in with almost like a traders dashboard at my desk saying okay, servers, marketshare in France, green. Storage market share in Asia, red whatever it was. There was none of this data in a way that you could absorb it that you could measure people on. There was not a consistent scoreboard of data across business units. There was not a consistent customer loyalty metric so we have had to do a lot of blocking and tackling in terms of instrumenting this business. Therefore, obviating the need for future restructurings.

I don't want to go out on a limb on this but I will. I just don't think that under my leadership we are going to do another big restructuring. It was necessary because of the situation in which we found ourselves, but this is no way to run a company. You can't do this episodically. It has to be part of the DNA.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

I was wondering if you could comment a little bit on the businesses -- I think skeptical investors would say, well when I look at HP and I look at their four businesses, I am anxious that the end markets for at least three of those won't grow. With the four being PCs, Printers, Enterprise and Services.

So if you could think from a market perspective, I am not going to force you to make forward-looking statements about Hewlett, but if you think about the market perspective over the next three years, realistically what do you think each of those end markets grows? PCs, Enterprise Services, and Printing?

Meg Whitman - *Hewlett-Packard - President and CEO*

Okay. So let's start with printing, which is obviously a core business for Hewlett-Packard. Our view is that the consumer printing business is a negative business for -- in the low single digits negative for the next -- five foreseeable future. Unless we do something that actually grows the category, and I go back to my consumer-products days, that we as a category leader in home office and personal printing, we ought to be able to



figure out how to grow that business. So whether that is the ease of printing off your mobile device, whether it is the next generation and breakthrough of photography printed by these businesses, we have not given up on growing the category which is our responsibility as a leader. But absent that I would say it is a low single digit negative growth.

On the Enterprise side, we actually see a 1% to 2% growth rate. The enterprise printing is not shrinking as you look around the globe. And part of that is because so many enterprises in emerging countries are actually growing their printing even though in the US it may be flat to slightly declining.

But our role in printing as the category leader is we ought to be able to gain share in that business. We ought to be able to have new disruptive business models that allow us to gain share and whether that is ink in the office or our ink subscription, or our new multifunction printers.

On PCs, if you narrowly define the market as PCs, I think there is a lot of debate about what this looks like. Is it the Draconian continued at minus 14% scenario? Is it sort of minus 6% to 7% or does it start to flatten out? My view is it is probably the middle, that it is a declining market. But we think about this business not as a PC business but as a Personal Systems business and we have called it the Personal Systems Group for a long time. I don't know that we acted on that business definition as aggressively as we should have, but we are moving now aggressively to mobile, to multi-OS, multi-architecture strategy as fast as we can get there.

And so the growth in that business will be determined on how well we get into these new categories of multi-OS, multi-architecture, and then is it the Draconian PC decline or is it a more modest decline? My personal view is that this will be more modest for a couple of reasons. One is, there is 140 million laptops out there that have not been upgraded in four years. Eventually something will happen to those devices. Either they will all move to tablets or they will move to a hybrid, which we are betting on heavily which is all laptops, all tablets, all in one like our ENVY x2. And we are obviously going to be in the tablet business as well.

So and then there is, of course, on the commercial side, the XP upgrade. Remember XP moves its support from Microsoft, I think it is February of next year and a lot of businesses are -- 40% of enterprise and small business customers still run XP. They're going to have to figure out what they are going to do. Either they are just not going to pay for maintenance and let us lapse or they are going to upgrade. So that is the pros and cons there.

In terms of services, services should ultimately be a growth business for us and because it is growing in the market and this whole move to the cloud, every app has to be modernized if you're going to move to the cloud. Data center consolidation, a lot of the work that RES Group does is highly relevant to this new style of IT and we are building practices around cloud and mobility and big data.

So I would say that probably industry growth rate is 2% to 3% up. We ought to be able to do better than that over time. Now we still have account runoff this year and next year, but endemically, we ought to be able to do better.

Enterprise Group, this should be a growth engine for us. The anchor on that growth rate in the second quarter was, of course, our performance in industry-standard servers and there was a lot of pricing pressure. There was a whole host of issues there, but as I said on our call, we simply have to do better in industry-standard servers. And, of course, the big game changer there, of course, could in fact be Moonshot.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Okay, thanks.

Meg Whitman - *Hewlett-Packard - President and CEO*

Did I cover all of our businesses?



Toni Sacconaghi - *Sanford Bernstein - Analyst*

You did.

Meg Whitman - *Hewlett-Packard - President and CEO*

I think I did.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

If you think about going back to that point on the last quarter and some of the pricing pressure, I think you talked about profitable growth, and sort of staying above the pricing fray. The consequence this quarter was that you did see share in PCs and in servers and profitability was good, came in above expectation, etc. But you did have below absolute revenue growth. And so more broadly I guess the question is how do you think about this notion of focusing on profitability because to the degree that it ends up with a significant negative result, obviously that puts these scaling pressures on you, right?

Meg Whitman - *Hewlett-Packard - President and CEO*

Correct.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

So do you think of a minimum level of growth that is acceptable or a minimum level of share or how do you -- how far are you willing to go in that profit revenue trade-off? What is the framework by which you think through that?

Meg Whitman - *Hewlett-Packard - President and CEO*

So, I think about this as the power of and. We have to hold or gain share and as a result, that means we are going to have to win more deals than we did this time but in order to hold profitability we have got to adjust our cost structure. And so the and is we have got to win deals and we have to go for profitability which means we have to adjust our cost structure.

And there is a number of elements to the cost structure -- and I will take industry-standard services as an example. So we have to make sure that we are segmenting the market very precisely and we are designing the product specifically for a market segment. And what has happened -- and I think it is because we are such a fantastic engineering company, there is a bit of a legacy at HP, if we build it they will come. That is not the world in which we live today. You have to have a very precise market segmentation designed to a price point with a set of features that that market segment is willing to pay for.

And my view is that the low end is growing very rapidly, whether it is low-end PCs in Brazil, or 1P servers here in the United States, and we have got to not over engineer our products but have the best quality and the best features for a given price. So we have some work to do around the product design which drives, of course, costs.

We have to be very thoughtful about SKUs. We have talked about this before. There has been a growth -- before I came to HP in the number of SKUs, in the number of platforms to which we design. This is a huge driver of costs. Think about the parts that you have to inventory, think about the inventory of SKUs that have to be at the right place at the right time for the right customer. Think about the inventory obsolescence that that huge number of platforms creates.



So we are continuing to work on our platforms and SKUs. We are working very hard on our market segmentation and designing product for specific market segmentation and then we are working on our supply chain, which I think is among the best in the world. But as this new style of IT moves to more mass customization, we have got to be more agile and more nimble in our supply chain. And remember, we produce -- I think it is literally like 100 PCs a second. The scale at which we operate here is so enormous that we are used to rack them high, stack them high and watch them fly. That is still very much a part of our business but there is also a mass customization that demands an agility and a supply chain that we are working hard on. And if we do those things, then we ought to be able to gain or hold share at profitability levels but we can't do that if we don't adjust how we do business.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

We have about seven minutes left, so you have been very succinct and I appreciate that and I'm going to --

Meg Whitman - *Hewlett-Packard - President and CEO*

I will even be more succinct.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

I'm going to actually see if we can enter the lightning round, which --- and CNBC as many questions as possible in five minutes.

Meg Whitman - *Hewlett-Packard - President and CEO*

Okay.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

So that would be great. First one, I just want to revisit the notion of future capital allocation, so let me run a scenario by you.

Cash flow this year is supposed to be about \$7.5 billion in free cash flow. Let's assume that is a steady-state rate. Ultimately you would like to grow, let's assume 7.5%. There are probably four of the companies that I cover that are returning 50% or more of their free cash flow to shareholders. That would be \$3.75 billion per year. I think you yourself said earlier today that you don't -- you view more tuck-in acquisitions as kind of being a priority.

Is a 50% return to free cash flow once the balance sheet restored, something that is plausible? Have you given much thought to a profile for return of cash to shareholders on a steady-state basis after this year?

Meg Whitman - *Hewlett-Packard - President and CEO*

So what I will tell you is this is very much on our radar screen and now that we are in finally a net operating company, net debt position of zero, we now have the luxury to really focus on this. And we think about this on a returns-based investment and you will all be very happy to know that Ralph Whitworth from Relational is on our Board who is driving hard as I think we all should on a returns-based capital allocation. So if we can't do better than what our cost of capital is, then we should return it to you and we don't have a lot of ego about this. Our view is, listen, what is in the best interest of shareholders from a returns-based philosophy?

Toni Sacconaghi - *Sanford Bernstein - Analyst*

But other than acquisitions which obviously could go through that, HP is generally not a large capital-intensive company. There are clearly some investments that ---

Meg Whitman - *Hewlett-Packard - President and CEO*

Correct, correct.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

--- per cloud infrastructure that you have made, but is that ultimately the choice then or do you foresee other forms of capital uses going forward or is it really acquisitions versus return to shareholder?

Meg Whitman - *Hewlett-Packard - President and CEO*

I think it is really acquisition versus return to shareholder. This is a surprisingly not capital-intensive business. The most capital-intensive business that we have is HP Financial Services, which is a leasing company. And then next is Enterprise Services, if and only if when we do an IT outsourcing deal we actually take on the assets of that customer which we are doing less and less because that IT outsourcing business is changing.

So this shouldn't -- you shouldn't see a material change to our CapEx and one of the things -- one of the reasons that our cash flow is as strong as it is I have scrutinized CapEx much more rigorously than we had before.

Interestingly enough, HP had been run largely as a return on sales company that the focus on return on invested capital on cash flow had not been what you would expect from a company like HP. And so you can see the results of the focus on that in our most recent cash flow. Everyone in the company understands it. We have incentive plans in place and we are scrutinizing CapEx as much as we have scrutinized OpEx.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

I had a question from the floor that followed nicely to that. What is your working relationship with Ralph Whitworth? You talked about the focus on return on capital. Any other comments about what he is bringing to the Board and to the Company?

Meg Whitman - *Hewlett-Packard - President and CEO*

So he has been, I think, a significant positive for us on Hewlett-Packard's Board, and I have a very good relationship with him. I respect the fact that he has done a number of what he calls his projects that are HP like type situations and he has learned a lot from those and he is sharing that with us.

So I am really quite delighted with Ralph's participation and what he has brought to the Board. He has been a positive force, for sure.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Will the rapid growth of cloud infrastructure services, such as AWS, Google Compute Engine, Microsoft, Azure and others be significant headwinds to the server business going forward?

Meg Whitman - *Hewlett-Packard - President and CEO*

So I think this is a very good question and one we think about a lot. I do think that there will be some deflationary pressure on infrastructure sold in the old style. And I will give you an example which you may have heard me talk about before.

When I was the CEO of eBay, we had no choice but to build our own data centers with EMC, with Cisco, with an infrastructure that we had to build for peak capacity, which was a holiday season. So we built the church for Easter Sunday. Today we wouldn't build the church for Easter Sunday, which is great for our customers and I think does put some pressure on the infrastructure in the old style.

So that is why we're investing in HP Cloud Services, that is why we are investing in Moonshot, because my view is we have to leap to the next technology, better to do it to ourselves than have someone else do it to us.

And so I think actually as the infrastructure spend perhaps becomes more efficient for everyone from big companies to small companies, then there may be the opportunity that those companies spend more money on other things -- security, big data, mobility, solutions that help them grow their business.

So my view is, IT spend may be as you predicted, but the mix of that IT spend may be quite different in terms of infrastructure-as-a-service, platform-as-a-service, certainly software-as-a-service. Because one of the interesting things about the industry is everything is changing, how technology is consumed, how it is bought, how it is paid for, which I think opens a huge opportunity for HP. This is a good thing for us. If nothing was changing, I would be a lot less optimistic about our ability to lead this resurgence back to where HP should be in the industry.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

How important is changing the business mix of services from outsourcing to consulting to achieving the long-term margin goals for this unit? Can these margin goals be achieved by simply being more selective about the outsourcing deals you take on, i.e., shrinking (multiple speakers)?

Meg Whitman - *Hewlett-Packard - President and CEO*

Yes. So we -- I think we can hit those margin numbers without changing the mix of the business. This is a business that in all candor, was not very well run. I mean we talked about the IT investments that were necessary. We now have a leadership team that is running this business very well and even though it is shrinking, because of a number of key accounts runoffs, that will sort of ease off at the end of 2014 and then my view is we will begin to grow that business. But we can do so much better. There is significant profit increase in that business, exactly with the mix that we have.

And then to the extent that we can build the strategic Enterprise Services, that is where you would actually see some upside to that margin. But we have got very -- the good news about the services business is when run well, it is a very predictable business and then you have to hit your in quarter, in your book to bill ratio, but a lot of your revenue is already in place for next year.

So we have a lot more visibility, interestingly into that business than almost any of our others and I have to say I think our management team, the change we made earlier this year, they have done a great job.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Last question, Meg. Maybe you can give the investment case for HP. What part of it is most underappreciated or misunderstood by investors?



Meg Whitman - *Hewlett-Packard - President and CEO*

So the way I think about this is we have a set of assets, as I said before, put together by my predecessors that are perfectly suited for the new style of IT. What we need to do is to make the investments in these growth businesses that meet our customer's needs, whether they be our partners or our end-user customers. And we have scale and distribution that can be utilized to our advantage.

And so that is the investment thesis that we are best positioned to provide solutions for the new style of IT, to businesses and enterprises of all sizes with enough anchor in the consumer side of the device business so that we can provide our enterprise customers devices that they really want, and that we are really well positioned to take advantage of these tectonic plate shifts and restore HP to the rightful position in the marketplace.

And if we do all that, the multiples should go up because I think we are still trading at a multiple that exhibits concern about the long-term growth rate of the Company, concern about whether we will actually deliver what we say we would do. I think the runoff in the stock price to some degree has been because actually you all are gaining some confidence that we are actually going to be able to deliver and that we're going to do what we say we are going to do. And if we continue to execute assuming we don't get any earnings per share increase, which of course we will, there is a pretty good thesis there that if the multiple expands and we tread water, that is a plus. If the multiple expands and we deliver the earnings per share, that we hope we will, then that is a good stock price story.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Meg Whitman, thank you very much for your time. We appreciate it.

Meg Whitman - *Hewlett-Packard - President and CEO*

Thank you. Appreciate it.

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