

# FINAL TRANSCRIPT

**Thomson StreetEvents<sup>SM</sup>**

## **HPQ - Hewlett Packard Co at Sanford C. Bernstein & Co. Strategic Decisions Conference**

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### **Toni Sacconaghi**

*Sanford C. Bernstein & Company, Inc. - CEO, President*

## PRESENTATION

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

Good afternoon, everyone. I'm Toni Sacconaghi, Bernstein's IT hardware analyst. I'm very excited that we have Leo Apotheker, HP's President and CEO, joining us today. Leo joined HP as CEO in November 2010. Prior to that, he had been at SAP for over 20 years including as a member of the board from 2002 to 2010, and he served as Deputy CEO, co-CEO and CEO between 2007 and 2010.

In the months since becoming CEO, Leo has outlined his vision of HP, which is focused on a desire to capitalize on cloud-based trends and leverage HP's combination of consumer and corporate capabilities. Moreover, he has provided a longer-term EPS target of at least \$7 in EPS in fiscal year 2014.

That said, the last several months have been challenging ones. HP has faced a softening consumer PC market, challenges from the Japan earthquake and disappointment in its services business, which has led to a step up in investment.

HP's stock is trading at a significant discount to the S&P, reflecting myriad investor worries. Of these, several key questions exist. Does HP have the right enterprise portfolio to compete against its large-cap peers? And will acquisitions be required? Two, are there businesses beyond services that HP has under-invested in? And three, how attractive are the PC and printing businesses likely to be in the face of tablets going forward?

Leo, we thank you very much for your participation in the [SBC]. We look forward to your helping us address these and other questions. And, Leo has been so kind as to do a fireside chat with me, and we'll proceed in that fashion and welcome your questions through cards in the center. Perhaps we can put up the disclosure slide, and then we'll begin.

We're not sure if we have a disclosure slide, but everyone should be cognizant of the fact that Leo may be making forward-looking statements in his prepared remarks, and all that other legal gobbledygook.

Okay, with that, Leo, thank you again and let's begin. Maybe we can take a step back and go back to the Summit in March. At that time, you outlined a vision for HP that discussed forthcoming discontinuities and seizing the cloud-based opportunity. So maybe you can kind of briefly outline what specific opportunities you see why HP is well-positioned.

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

Well, first of all, thank you, Toni, for having me at the conference. Pleasure to be here. And let me try to give you a little bit of a perspective of where I believe this industry is going towards and why I believe that HP has a unique opportunity.

So from my perspective, and I believe more and more peers in the market are coming to that conclusion as well, what we are seeing right now is this convergence between cloud computing and connectivity -- as some people call it, mobile life extenders or connectivity -- as probably the biggest disruption that this industry has seen since the last 20-25 years, since the advent of the client/server computing model.



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And it's a massive disruption also, among other reasons, because IT plays a much more significant role today than what IT played 20-25 years ago. Today, nothing would function without IT. 25 years ago, that wasn't exactly the case.

So we have this massive disruption happening at the same time as we see some other big trends happening that are driven by big progress in computing capabilities, such as real-time analytics and the ubiquitous availability of networks make the connectivity play such an important one.

So HP is, from its portfolio, from its capability to address different markets, from its breadth and width of its technological capabilities, ideally placed to actually shape that market, create the kind of architectures and infrastructure plays and service the space and solution plays to that required -- to really drive this market forward. And that's why we articulated the strategy as we articulated it in March in San Francisco, and now we are kind of focused on making the execution happen that will drive this business forward. But I'm sure we'll have ample opportunity. We are going to be there.

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

As you think about trying to fulfill that vision, what changes are required at HP? And do you view an evolutionary or revolutionary change required under your leadership going forward to try and fulfill these opportunities?

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

You know, when you run a COMPANY of the size of HP, the term revolutionary is definitely worse because it's too large and it has too many ramifications to be revolutionary. What you want to achieve is the fastest evolutionary path possible.

Now, you really need to take a harder look at the entire HP portfolio to really understand what it is we're trying to do. So, like any other Company, there are -- but we do this, I believe, really well -- we are a disruptor in a number of markets. That's probably not really recognized by many, but when you look at what we are doing in the networking space where we are disrupting companies massively, we create a business that gives us margin capability that is twice the average of HP. We are growing this business at double-digit rates every quarter, and we are disrupting the incumbent in a massive way, both technologically and price performance-wise; we are a disruptor.

When you look at what we're doing on the storage side with 3PAR, we are a disruptor. We are creating a next-generation architecture that helps us truly disrupt the whole market of storage. If you look at what we are doing when it comes to analytical real-time unstructured data, we are in a position now to disrupt the market.

And when you look at what we are doing in the cloud with our massive capabilities to create converged infrastructures that we can bring together on the -- a lot of HP IP to create an infrastructure of the cloud tomorrow, we are disrupting the market, or at least we are leading the market.

And then there's webOS. I'm sure we will get to talk about webOS as well, where I believe we can disrupt the market as well.

Now, there are parts of our business where others are trying to disrupt us. That's fair, and that's the way it should be. So parts of our Industry Standard Servers, people are trying to disrupt us. I'll be happy to discuss why I don't think they will be successful, but that's an attempt of others to try to disrupt us.

When you look at what is happening on the commodity PC side, basic PCs that are industry standard, that's basically just a scale business and there's no differentiation. I hope we get the chance to talk about what are the trends impacting the PC business and how I believe HP can really change the game there as well.

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So altogether, then, the services business, which is a whole issue in itself which is a massively important opportunity for HP and where we need to take a certain number of steps to really make sure that our services business is well-positioned for the future.

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

Leo, you talked about fast evolutionary change. Do you think HP has the portfolio of assets needed to allow you to do that? Or, could we see an aggressive reshuffling? And I would define that as a \$10-billion-plus divestiture or acquisition.

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

Okay, let's take a look at that. So we analyze each one of our businesses and the moves that we are going to make in the framework of the strategy that we have laid out. And, therefore, we take a hard look at all of our businesses and try to assess all of these businesses in the sense -- do they fit the strategy, are they still meaningful businesses, can we differentiate them, do they contribute to the financial performance of HP, and are there better alternatives that we could search for?

And by the way, just as a small organization that couldn't meet your requirements, that's how we came to the conclusion to divest Halo business a couple of days ago.

So what we are really focused on is actually making sure that we have the best possible portfolio to live up to our strategic aspirations. What are these strategic aspirations? They are to become the market leader in cloud, both public cloud and private cloud and hybrid clouds, from infrastructure to platform to open marketplaces. We would like to be the leader in connectivity, not just in mobile platforms. And we would like to be the leader in the services and software that creates the insight that companies need in order to really manage their business from an analytical point of view. So it's more unstructured data than structured data.

And, therefore, it won't come as a shattering surprise to you, Toni, that when we look at our software portfolio, which is a nascent business for us, we need to strengthen that portfolio. And we will go about that through some M&A and some organic growth and some partnerships. And so, yes, there will be some M&A. And we will continue to look at all of our other businesses to make sure that they are well aligned to our portfolio.

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

But, given where you stand now and given this tension between trying to be evolutionary and yet trying to create rapid change, is a large transaction on the table -- it's a possibility? And should investors be thinking about that, both from a divestment or an acquisition perspective?

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

I don't think we should be talking about those things. A, it's something we can't discuss anyway. Secondly, I think people should simply take what I said at face value. We really want to shape the best portfolio possible. We are going to drive the business in order to achieve at least \$7 EPS FY 2014. I can just restate that statement. And we will do the necessary adjustments if we need to make them.

Now, bear in mind we can achieve this \$7 EPS in a variety of ways. We have some businesses that will continue to our margin expansion -- example, networking; example, software. There are some businesses that will help us grow like, for example, storage; that's a business that will continue to grow. By the way, our server business will continue to grow as well. And we have some businesses where, indeed, we have to make some investment -- example, services, where we need to reshape the configuration of our services business.

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Ultimately, what we will try to do, and I am convinced we will achieve that, is to grow our business, grow our operating profits faster than our revenue growth and grow our EPS faster than our operating profits because at the end of the day that is the one element that's the easiest one to control.

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

If you were to -- you mentioned the \$7 target. And collectively, your actions will be taken in the spirit of achieving that. Is that how you define success? As you think about your impact on the business three or five years from now, what are the measurements that you will be looking to evaluate yourself, and what are the measurements that you think we should be looking at to evaluate you? What does HP need to be or have done three or five years from now for you to be able to say, look, we have done what I achieved? Is it just the \$7?

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

So, five years goes way beyond the \$7.

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

Three -- well, I gave you three and five.

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

I was just trying to qualify the answer. So one of the key elements, of course, that we see or want to achieve is to make sure that a lot of shareholder value is created so that EPS number is one way of getting there. It's not the only way to get there, but I thought it was important to put a number out there so our investors, our customers, our employees, everyone understands that that is an objective that we will be driving for until FY 2014. I'm sure, as time will move on, we will come out with further guidance. And this not really guidance; it's an objective that we gave ourselves. But that number is out there.

Now, that's not the only thing you should be looking for. We want to create, as I said to the employees, in a certain sense the best Company on the planet. As I have shared with many of our employees and our executives, I would like HP to be a Company where they would like their children to work at. And that means something in terms of quality of our products, level of service that we provide our customers. I would like us to delight our customers. You see, the interesting thing is, when I talk to our customers, I haven't met a single customer yet -- and I meet many customers; that habit hasn't changed -- and that all of them would like to buy much more from HP. But in order to make that happen, we need to make adjustments in the way HP goes to market. We need to become more of a solution provider and not a product provider, per se. And we will take some steps to make that happen, which is why the services changes are so important. We need to have a much -- we need to be able to provide the entire portfolio to our customers and not just parts of it, therefore some changes in the sales configuration as well. And of course, our customers would like us to help them transform their businesses from where they are today to where they would like to be tomorrow on the mobility side, the connectivity side, the analytical side and the cloud side of the business.

If HP can achieve leadership positions in all of these aspects and actually shape the market and lead the market and be ahead of the curve, together with my \$7 and hopefully much more shareholder value, I will be reasonably satisfied.

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

You mentioned the \$7, and you said within that parameter you will grow operating profit dollars faster than revenue and then EPS faster than [interim net] operating profit dollars. The \$7, given your guidance of at least \$5 for this year -- that implies 12%

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EPS growth from 2011 to 2014 -- compounded, obviously. That is a significant number for a company of your size, \$125 billion in revenue.

How do we -- I understand the construct of, clearly, you are going to get some operating leverage, clearly you are going to try and reduce the share count to drive EPS higher than operating profit or reduce the tax rate. But how do we think about those relative contributors? Because the 12 still strikes me as a potentially aggressive number.

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

So let's just take a look at what happened in Q2. In Q2 we grew our non-GAAP EPS by 14%. And by the way, we have been growing our non-GAAP EPS, since I joined HP, every quarter. So that's just a fact.

So how do we do this? Well, the first thing we want to do is we have to impact our growth story. And that's part of the portfolio adjustment that we just talked about. And the other thing is that when you start to adjust the portfolio and we start to move into higher-margin categories, the mix shift will help us drive a significantly better growth model. At the end of the day, that's where it all starts -- better revenues, better gross margin so we will be moving up that value chain. As we do this, gross margins will improve and we will have a very, very tight focus on our operational excellence. We want to be absolutely perfect (inaudible) operations, which we are already today. I think we can become a lot better. Initiatives that we have launched called Project Orion around quality, about process efficiency, about execution quality and about our supply chain and a few other things will make sure that our operational focus will remain razor-sharp. So you combine the effect that we can have on gross margin, the disruption that we are doing in some businesses, sharper operational focus -- all of these things, together with some growth that I would estimate at market rates will get you to this 12%.

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

How would you define as -- that was actually my next question. So what do you think is the addressable market growth rate that HP plays or participates in?

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

Well, I take a slightly different view on that. I'm actually not so much interested to figure out how much a particular market is growing. I'm much more interested to figure out how do we capture lion's shares of markets, given our size? So take clouds. So we are already a multi-billion-dollar player in cloud. Seven out of the 10 most visited websites are run on HP cloud services and systems. The same is true for the most visited search engines, the most visible social networks, etc., etc. So we are massively engaged in cloud. We have thousands of private cloud customers. So we are already a pretty big cloud player today.

But it's a market that is estimated to be, in a couple of years, an order of magnitude of anywhere between \$100 billion to \$150 billion. Why shouldn't HP have a nice chunk of that market? So we really want to gain market share in those businesses. We would like to see our software business grow significantly faster than what it is growing today. And just as a side comment when we talk about execution, and it hasn't been discussed that much in the quarterly earnings, look what happens when you start to focus on the business. You take our software business. In Q2 that grew, total software business, by 17%. Licenses grew by 29%. Just operational excellence, just focus. We haven't even made big changes yet.

So this Company knows how to execute. We want to grab some market shares that we don't have today. And therefore, I am not terribly keen to figure out if TAM will grow by 1% or 2% or 5%. I am keen to figure out how we can dominate a certain number of marketplaces.

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

On the aspirations to grow, both accelerate the revenue growth and improve margins, can you do those concurrently? If you take services as the proxy example, last quarter you effectively said, look, in the short term we are going to have to make investments in services because we want to build a better services business. And you're taking a margin hit in the meanwhile.

And so, if we take that and extend that to your portfolio and you are effectively saying we're going to try and accelerate the growth rate, and we are going to make some investments there, is it realistic to think that you can accomplish both those things simultaneously? And fiscal year '14 sounds like a long ways away; but it's not, really. It's only three, and you don't build businesses overnight. And every point of revenue growth is an extra \$1.3 billion of new revenue -- you know this better than I do -- you've got to find every single year.

So I go back to -- the 12 to me feels daunting. I'm an analyst, so I can't help looking at addressable market sizes. And I feel like your addressable markets grow three or four, collectively. And yes, you may have some outstandingly significant contributors. But if it's three or four and you are going to be making a bunch of investments, so I've got 3% or 4% revenue growth, I'm making a lot of investment -- yes, maybe I get the longer-term operating margin improvement. But do I get a lot of that between '11 and '14? I don't know. I'm not sure.

So how do you reconcile those potential constraints with your previous statement?

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

So even if you make that assumption that the market grows by whatever, 3%, 4% or maybe even 5%, that doesn't mean that we will grow at the same rate in each one of our businesses. So I think what's really important to talk about here is the mix in the businesses. So let's take as a proxy, instead of taking services, let's take networking. That's a business where we now have great capabilities, where we are adding R&D on a small incremental basis so that it can create the best cost/performance equation in the market.

Now, that business generates, on the average, margins that are twice as high as the Company average. That business grows on a much higher rate than the single-digit numbers we just talked about and will continue to do so because that's an industry that is exploding. And we are also disruptive.

So I think the danger in a conversation like the one we are having now is that people tend to assume everything stays equal. That's not true. The mix in the business is as important as the overall growth rate. So that's the one thing you have to bear in mind, so networking is one good example. Storage is another good example. Software will be a third very good example.

That helps to compensate the investments that we have to make. Now, you are absolutely right; there are some spaces where we have to make investments. Services is a perfect example. I'm happy to discuss this in further detail. So we have every interest on the planet to make these investments as soon as we can, so we get them done and we can have a better line of sight for FY 2014. The sooner we make these changes, the better.

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

How about capital allocation and share repurchases? The stocks -- you've bought back \$5 billion worth of stock year-to-date. The stock is at a significantly lower level than that now. You have a whistle-clean balance sheet. Debt is really cheap right now. Why wouldn't you be extraordinarily aggressive in repurchasing your shares right now? It would give you a lot of that EPS cushion or leverage in out years. Why wouldn't you be aggressive, you know, buy back \$5 billion to \$10 billion worth of stock between now and the end of the year?

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

So, for starters, we are very aggressive; in the market, we're buying back a lot of shares. I completely agree with you; the shares are ridiculously cheap. So it's a great investment. And, therefore, we are buying aggressively.

I'm happy to confirm that in Q3 we will be buying back for at least \$3 billion of shares. So we are in the market. We are buying back shares. You are absolutely right; at this price, that's the best thing we could do.

Now, on a more global scale, though, we will still continue to have the capital allocation where we want to use our cash to reinvest into our business. There could be M&A as well, share repurchases and dividends. We increased our dividends this year by about 50%. And I'm sure that we will get the approval -- or I'll at least talk to the Board, and hopefully we will get approval from the Board to continue over the years to increase our level of dividend every year. But that's basically, if you want, in three big buckets, how we want to allocate our own capital.

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

Have you thought about -- I'm sure you have. Can you share with us how you think about taking on incremental debt? Because you do have a number of priorities. Stock is very cheap. It sounds like you are committed to sustaining or raising the dividend, and you want to make investments in the business. I think you are basically at zero net debt, ex-your financing business. What kind of debt capacity do you think HP has, and what are the pluses and minuses to potentially taking on more debt? In the near-term you generate about \$10 billion in cash, so you could obviously pay that off. How do you think about the pros and cons of taking on incremental debt?

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

So you probably have noticed that we actually took on some incremental debt very recently. [I can] only indicate that we are willing to do that. We will take on incremental debt if, A, we have the opportunity. B, what we don't want to do is to lose our credit rating because we have a reasonably good credit rating and it helps us to raise cheap debt when we need to raise some debt.

And as I said, we will raise debt or do whatever we need to do from a capital allocation point of view, based on those three criteria I just mentioned -- invest into the business, M&A -- same thing -- dividends, and, of course, share repurchase.

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

Maybe we can talk a little bit about the services business. I think probably the most common question that I've received since earnings is, how does the Company miss services, kind of the issue that has come up in services or the issues that led to the reduction in guidance? Maybe we can start with that.

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

So I can understand that question. Let me try to describe to you why it really happened. So HP had a pretty large services business that is very important both from a financial point of view and from a strategic point of view. That business, when HP acquired EDS, it was clearly articulated that what we really wanted to do was change the mix and revenue streams in that business. So that strategy has a smaller part of our business and IT or on outsourcing, they move up the stack and higher-value businesses.

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When I joined HP in November, I did the first review of all of our businesses. The headline numbers on services coming out of Q4 were okay. We grew by about a percentage point. Margin was significantly higher. Actually, I felt already in those days that the margin was maybe a little bit too high, was defying gravity if I compare HP to every other service company on the planet.

But I have decided not to dive any deeper at this moment in time because there were other priorities that deserved a much deeper look and I reserved services for the second half of the year. Then came Q1, and you will remember that we had a bit of a surprise in services in Q1, which made me change my priorities, and we dive deep into services.

Now, what did we discover? We discovered that despite the intent, the mix in revenues did not change. Actually, it hasn't changed materially since the day we acquired EDS. We do about 40%-41% of our revenues in ITO and outsourcing. And for those who are not familiar with outsourcing, that's a pretty tough business. It's a tough business because, A, it takes a long time on a contract to generate profits. And when you renew an ITO contract, usually you renew it at a lower price. And when you sign up new logos, A, they are usually already after some restructuring. So it's harder to generate profit. At the beginning of any ITO cycle, you invest money and you only make profit at the tail end of a contract.

Now, the reason why we didn't generate more Application Services is a clear consequence of underinvestment into the business. If you want to be in the apps business you have to have a bench because when the sales people and the account managers find the apps opportunities, they must be able to deliver. If you have no bench, you can't deliver. We didn't have a bench. We were running this business with almost 0% bench.

And, third, we didn't invest into talent in this business, or at least we have a big shortage of good talent. So, to address that, we actually brought in some outside talent into this business, people who really knew this business, and particularly on the application and BPO side. So that helps.

We are putting a much more stricter guidance on what kind of deals we sign and what kind of deals we do not sign. That will help. We will start to bring in additional capabilities. That will help. And we have made some organizational changes.

Which ones are those? We are going to bring in an EVP for that business that will be a world-class leader of services, of IT services. We are putting our technical services, which is break-fix and network consulting, under ESSN, so that's a continuity in the sales force. And we have created two new entities in our business. One is an entity that will create vertical IP based on the IP we already have, and we will expand that at IP -- in other words, software. And there will be a shadow, a mirror organization on the services side, that will be very capable of implementing vertical strategies and practices.

So, bringing all of these things together, I think you will see nice change in our services business starting to be visible to everyone in the next four to six quarters. And then we will be permanently looking at the portfolio of our services business to make sure that we drive that business up the stack and are not stuck too much into lower-level work.

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

What would be the milestone or explicit markers that we could look to four to six quarters from now that would suggest that these investments are these changes or working?

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

I believe that the first thing that we will do is to deliver on our guidance for the services business in the second part of the year. And I would like to remind everyone that we have given our guidance on our op margins for that business to be between 13.5% to 14%, or a little bit on the lower side in Q3, higher side on Q4.



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And then I think we'll have my ample opportunity to discuss more details and guidance for FY '12, when we will meet for the analyst session.

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

But would success ultimately be just qualitatively improving revenue growth? Would it be improving mix, or would it be improving margins, when you get there? I'm not asking you to give any guidance beyond the two quarters. But again, what would ultimately define success, in your mind?

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

Success will -- A, I don't believe that you can run a business, any type of business with zero or even small declining growth rates. That doesn't work. Not in services; that doesn't make any sense. So the first thing you will see is that we will come back to growth in services, once we have restructured the portfolio. And if we do a good job, we should see a good margin business with sustainable margins. So that kind of surprise that we had to announce in Q2 will not happen again.

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

Leo, you mentioned the chronology of services, an okay Q4, not a great Q1, in the (inaudible) the business, etc. Another question that I frequently get is, is there a risk that there are other parts of HP where there has been underinvestment and that, as investors, we could be surprised or as the CEO Leo could be more surprised than he would have thought? How do you address that question? Perhaps you can go through each of the other three businesses and give us your conviction level on their health?

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

So, why don't we do that. And let's scrutinize this together, shall we?

So let's start with the PC business, which has received some headline news recently as well. So the PC business is basically [a tale of two sides to the coin]. On the one hand --

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

Is that a German expression? I'm not sure how that translates.

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

It is. I'm sorry for that. It's a Janice-faced opportunity. You know Janice had two faces? That might be a more universal statement. So the good news on the PC business is the commercial side of the house, or the non-consumer side. That business is growing double-digit, continues to grow double-digit, is doing really well. We have now achieved market leadership in the non-consumer side of the house everywhere, in particular in the enterprise space in the US, which was really important for us to gain that first place. So we have it. We are the market leader in Brazil; that's a great thing. So we have a mix of these refresh cycles, and it's going really well. It has been growing in Q2 again by 13%. So that's the good news on the PC side.

The less good news is on the consumer side, which is right now in a valley. We have addressed all of our issues, so the business in China is picking up really well. We're generating sequential double-digit growth. We have gained significant share in Q1, and it probably will be gaining significant share in Q2, calendar Q2.

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And then I believe that we're not that far away to have regained all of the shares that we had in China before we had our particular issue in China. And the satisfaction levels of consumers are exactly back to where they used to be, before we had our events in China. So that's the good news.

We see some trends affecting the PC business. Some people talk about the tablet effect. Some other people are talking about the economic impact. I think both are a little bit impacting the consumer. I believe, over time, there are some really interesting opportunities that are opening up that didn't exist in the PC business in the past, which is to create, again, innovation in the PC industry.

When you look at what is happening around ARM, the fact that Microsoft will support ARM for Windows -- for the next edition of Windows. That creates a whole set of new opportunities for the OEMs. And we are actively looking at trying to capitalize on that. And webOS will actually help us on that.

The other thing we are doing really well on the PSG side of the house is webOS. So webOS is ready for prime time. It's now out on a small phone, the Veer . And it will be out on the format of the tablet by the end of June/early July. And it will go into distribution then. We are all about webOS. We are more than about this with the other form factor. And I am happy to reconfirm that webOS will be available on PCs, on top of Windows, which creates a whole new market dynamic for webOS.

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

Do you have a date for that? webOS on the PC?

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

2012. I know there are 12 months in 2012, even in Germany. And then we have -- and we are going to put webOS also on printers. So we can create the kind of a platform of about 100 million, 110 million devices a year. And by the way, we won't shy away from licensing webOS to others if that opportunity arises. Okay?

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

Just one follow-up, maybe a follow-up question on Palm. Is Palm exclusive and -- meaning an exclusive OS for tablets and mobile devices for HP, or could we see in the future, particularly if the market moves in a different direction or you don't get the traction that you would like to, that you would support either Windows or Android or another OS? And how do you -- where does the door close there?

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

Well, the door isn't closed. We are supporting Windows, aren't we, on our PCs, like 50 million a year kind of support.

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

No; I mean -- I meant on mobile devices being phones and tablets.

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

Sure. Right now we are focused on making our webOS successful. And as I said, I want to make sure people understand this in this room, it's not so much of, this is the other particular device, even though we want to be successful here. It's about the

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webOS much more than about device A or device B. And therefore, if it's about webOS it's about the particular device you can always decide that this is the other device where it should be available on something else. Just to bear this in mind.

So, so much for the PC business.

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

I have one more follow-up.

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

All right, but let me just go through the other businesses, and maybe we can do your follow-up.

Then we have IPG, or our printing business. That's the avenues that affected our quarterly earnings and our guidance going forward. [That's Japan.] I fail to understand why some of you were surprised in that, given the symbiotic relationship we have with Canon on the laser side of the business. You know that we have a single supplier situation with Canon for the laser business, and Canon actually came out before us with their guidance to the market, and it was pretty clear.

And therefore it is what it is. And we are impacted by the Japanese tsunami. I promise you, going forward, we will try to be better in geology and predict tsunamis in a better fashion. We didn't succeed in Q2. Maybe in the future we will be better.

Otherwise, IPG is doing really well; it's doing a great job. We are growing our commercial and our consumer business. We grew the commercial business by 7%, which is very good. We're firing on all cylinders. If the Japan event wouldn't have occurred, they would have had a banner year. I hope that somewhere in the near future we are back to the pre-crisis levels in terms of revenues for IPG. We are disrupting a significant part of this industry, and particularly the entire analog printing, and that's a great opportunity for us. We are actually moving massively into digital workflow management for companies.

So that's actually a future-looking business, not a backwards-looking business.

Let's talk about ESSN and our -- you know, the hardware business. We are the world leader in blades. If you compare us to Cisco, we have just been talking a lot about this recently, we shipped 10 times more blades in Q2 than they did. So they have a way to go.

We're number two in the world when it comes to UNIX servers. We are actually gaining market share; Oracle is losing market share. So it's starting to become a game of two, IBM, HP, which is interesting for us. So the server business is doing really well. We are adding innovation. I already talked about cloud systems, which help us to actually scale in a significantly bigger way. I won't go back into networking and storage. We already talked about that. We had a conversation on services. You know what's going on there.

On the software side of the house, the numbers are looking a lot better than what they looked three or six months ago, putting a lot of focus there. And our security suite is outstanding; it's gaining immense traction. Security is a huge issue, and without it for the cloud, the cloud won't take off. And we have probably the best solution available when it comes to security.

Our analytics baby, Vertica, is doing really well. It's one of the best examples where we are actually starting to put IP out as IP and actually using hardware to sell IP, not the other way around. There is an appliance available for Vertica, and in a certain sense here the hardware is selling the software, not the other way around. And our vertical applications are gaining traction as well, so we are pretty happy about what's happening on the software side. Much more work required, among others, we put another focus on PaaS, platform-as-a-service, where we would like to create in the cloud all of the capabilities required for developers to really be a true cloud provider, including open market places.

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So, so much for our software business, as you have a quick overview of each business.

Does that mean I sleep well at night? No. Can there be a surprise? Yes. Surprises are, by definition, something that you don't expect.

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

I'm going to go to the rapid-fire part of the questions, Q&A, we have about five and a half minutes left. So I'll try and deliver them quickly. And if I could get you to use all of your stereotypical German terseness, that would be great.

If you deliver \$7 of EPS, will you also deliver \$7 of free cash flow?

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

I haven't done the math yet.

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

Okay. On a scale of 1 to 10, what is your confidence level on the \$7? How much of incentive comp is tied to it?

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

None, eleven.

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

Software is less than 5% of profits. Building a software business internally or making small acquisitions won't move the needle; it's 50% of IBM's profits. Well, this is a really long question. How do you change that? How do you begin to pay for a real software business? \$5 billion will not cut it.

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

I'm not too sure that's true. I think that HP has the capabilities with scale to take a software business of some magnitude and make it grow significantly faster. We have demonstrated that with some of acquisitions we have already made, and we did this also with 3Com. I am confident that we can make great acquisitions in software and scale this business really quickly.

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

There was sort of a related question that HP's historical track record on acquisitions doesn't inspire confidence. Perhaps you would disagree with that, but what changes, if anything, moving forward are playing a part in how you do acquisitions?

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

I completely disagree with that. We have got 3PAR, 3Com, all of our security software acquisitions -- they all played out really well. They are all ahead of plan. So no; I don't think that's true. If anything, we just have to do what we do a lot better.

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

Why can't HP follow IBM's strategy, except that revenue growth will be limited and focus on margin optimization and EPS growth?

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

Because our mix of products isn't the same, and therefore you can't copy the same strategy. And by the way, why should a leader follow a laggard?

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

Okay. You are more terse than I thought, Leo.

You have said that you are targeting having 30,000 applications available on the Palm OS by the end of the year. And that would mean about 20,000 that were available for tablet devices. Can you provide any update on success in attracting application developers and the number of applications we should be thinking about in terms of being available for the tablet at launch?

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

So we are focused on getting the right applications on our devices. When you look at how people use these devices, in general people use 10, 12, 15 applications and not more. Actually, we are trying to create an environment where developers to get the kind of exposure on our catalogs the way they would like it to be. So, A, we are trying to get the right applications. B, we are trying to get the right portfolio of diversity of applications. And, three, we are creating a whole new app-catalogue, a whole new approach based on the magazine type of an approach so that people can kind of reasonably find out what we have. It's going to be a magazine called Posit, which will be available online after launch of the TouchPad.

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

And any update on that 30,000 aspiration in terms of -- is that still something you are an aspiring for, given this mention of getting the right apps as opposed to volume? And, secondly, can you comment at all about the range or size of apps we may expect at launch?

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

I think you should wait until launch, and then we will talk more about it. I just want to remind people that we are also going after the prosumer, and we want to make sure that we get the right enterprise applications and commercial applications on Web OS as well. And there, the number really isn't so relevant as the importance of them.

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

What's the sustainability of printer ink cartridge profits, given the shift to mobile from PCs and the perceived high price of ink cartridges?

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

Thank you for the perceived, because I don't think it's that expensive. As I said earlier, we are actually going after a much more important market than the consumer already is for us. We're going after the entire analog space, which is commercial, where we are trying to get people to shift business models and move from analog printing, which is basically print to stock, to digital printing, which is print to order and therefore significantly more cost effective and more beneficial for the customer. And therefore, HP would get a much bigger chunk of that huge market out there. Right now digital printing is in its infancy, and we believe we can drive a big change into that.

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

Final question, Leo -- can you articulate what the HP investor value proposition is? So what financially does an investor get by investing in HP? And perhaps you can then also add your pitch for why people should buy the stock today.

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

So the investor should know that we are absolutely committed to deliver \$7 EPS to FY '14. So you can already do the math on that. But moreover, you would be investing into a company where the upside is significant. If you compare us to all the other large-cap tech players, our upside to create new margin-accretive businesses is significantly better than that of anybody else in this industry. We had a chance Toni, to talk about a few of those. Actually, they are all going to be marginally accretive to our current business, given the baseline that we have. And therefore, the upside story on HP is just unbelievable. And we're committed to execute that, and it's going to be a great ride for the investors.

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

Thank you very much for your time today.

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