

# FINAL TRANSCRIPT

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## HPQ - Hewlett Packard Co PSG Decision - Conference Call

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**Meg Whitman**

*Hewlett Packard Co. - President and CEO*

**Cathie Lesjak**

*Hewlett Packard Co. - CFO*

**Todd Bradley**

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**Bill Shope**

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**Katy Huberty**

*Morgan Stanley - Analyst*

**Shannon Cross**

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**Mark Moskowitz**

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**Kulbinder Garcha**

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**Peter Misek**

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## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the Hewlett-Packard conference call. My name is Jeff, and I'll be your conference moderator for today's call. At this time, all participants are in a listen-only mode. We will be facilitating a question-and-answer session towards the end of the conference. (Operator Instructions) As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the presentation over to the host for today's call, Mr. Steve Fieler, Vice President of Investor Relations. Please proceed.

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**Steve Fieler** - *Hewlett Packard Co. - VP, Investor Relations*

Thank you, Operator, and thank you to everyone for joining us today. The participants on today's conference call are Meg Whitman, President and Chief Executive Officer; Cathie Lesjak, Chief Financial Officer ; and Todd Bradley, EVP of the Personal Systems Group.

This call is being webcast and a replay of this webcast will be available shortly after the call concludes.

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As a reminder, HP is in the quiet period ahead of the November 21 scheduled announcement of its fourth quarter FY '11 results. In that context, we will not be discussing the financial performance of the business, including PSG, and we are not providing any update on our Q4 outlook.

At the end of today's prepared remarks, we'll take a handful of questions regarding today's announcement.

Some information provided during this call may include forward-looking statements that are based on certain assumptions and are subject to a number of risks and uncertainties, and actual future results may vary materially. Please refer to the risks described in HP's SEC reports, including our most recent Form 10-Q.

I will now turn the call over to Meg.

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

Thank you, Steve, and thank you all for joining us. Today, HP announced that we completed our evaluation of strategic alternatives for our Personal Systems Group, and that PSG will remain part of HP. This decision has the full support of the board and the executive leadership team of HP.

What I'll do is walk you through the process that led to today's decision. Cathie will cover more of the financial details behind the decision, and Todd will offer some of his perspectives on PSG going forward.

In August, as you will recall, HP announced that we would explore strategic alternatives for PSG, including a possible spin off. At that time, we believed that a separation of PSG could unlock more value for our stakeholders. Given this possibility, it was necessary to conduct an objective and thorough evaluation to determine the best path forward.

In the 5 weeks that I've been CEO, we conducted a comprehensive data-driven process in with cross functional teams, consisting of subject matter experts, looked at the linkages between PSG and the rest of the HP businesses. This included revenue and cost synergies, one-time separation and startup cost, and potential execution risks.

We also considered how to continue providing our customers and partners with the best products, services, and experiences. Cathie will take you through more details of our findings in a minute.

But after reviewing the results of the analysis, the decision was actually very straightforward. HP and PSG are better together. A separation would not create incremental shareholder return or customer value. PSG is core to HP's portfolio, and it makes strategic, financial, and operational sense for HP to retain it.

Specifically, PSG benefits from HP's global reach, scale, and innovation. It contributes significantly to HP's supply chain efficiencies, component pricing, distribution channels, and solutions portfolio.

The HP brand stands for quality and innovation for consumers, small businesses, and enterprise customers across all geographies, including emerging markets. It would be very challenging for a new PC company to build such a strong brand.

And we also gain a lot from our shared infrastructure. In a separation, we'd lose many of the strategic and financial advantages that we've achieved over the years by consolidating areas like real estate, finance, HR, and IT. At the end of the day, the costs and risks of a separation are simply greater than any value we could create.

Now I'll turn it over to Cathie for some detail on the financial analysis leading to our announcement today.

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

Thanks, Meg. As Meg highlighted earlier, we needed to validate whether the economic benefits of creating two companies would be greater than the economic cost of separation. The analysis confirmed that there is real value in the combination of PSG and HP. We estimate that the annual synergies between HP and PSG exceed \$1 billion in operating profit per year, and enable HP to be more competitive as a whole.

Let me just go through a few examples. To begin with, we have significant supply chain and procurement leverage from the combination of enterprise service storage and networking and PSG. As you know, we are one of the largest purchasers of components worldwide. We ship 2 PCs every second a server about every 15 seconds. This scale helps our gross margins for both PSG and enterprise server storage and networking.

Next, there are revenue synergies and pull through associated with HP brand and our channel relationships. A spin would cause us to lose those synergies and require incremental investment in channel, sales, and market-- I'm sorry, marketing. And the cost of creating a new worldwide brand would be significant.

And finally, from an operational perspective, PSG is deeply intertwined with HP. We estimate that a spin would require an additional investment of approximately \$1.5 billion in one-time startup costs such as building a new brand for the new PSG company, or new systems for IT, support, and finance, etc.

So to summarize, there are 3 key takeaways. First, PSG provides financial value to HP. It generates solid cash flows. Over the past 4 reported quarters ending in Q3, PSG generated \$2.3 billion in operating profit, a record for PSG. And its return on invested capital is quite good.

Based on our analysis, HP and PSG together create more shareholder value than what we would expect to achieve with two separate companies.

Second, we believe that the one-time upfront separation and startup costs are material. Right now, we have much better ways to allocate our capital to generate higher returns.

Third, we believe that PSG can continue to win as part of HP.

I'll now hand the call over to Todd who will talk about how PSG will accomplish that going forward.

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**Todd Bradley** - *Hewlett Packard Co. - EVP, Personal Systems Group*

Thanks, Cathie and Meg. As you've heard, HP remains committed to the PC business. And my team and I are pleased that this review has shown PSG and HP are much better together. One HP provides our customers a better experience, based on the unmatched portfolio of services, solutions, and people. We heard this very clearly when we spoke to customers and partners from New York to Shanghai over the past several weeks.

In addition to providing a one-stop shop for their technology needs, one HP gives customers a more comprehensive support experience. And the knowledge that PSG, like all of HP's businesses, remains firmly committed to the quality and innovation that HP stands for.

The direct personal connection our customers have with PSG products reinforces HP's brand for so many people. We ship more than 60 million PCs a year. And our customers interact with these very personal products every day. We're committed to making the number one PC business in the world even better for them.

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Back in July, we restructured PSG, aligning it with our primary customer segments -- commercial, consumer premium, and consumer volume -- which helps us gain insight into the innovations that matter most to our customers. This way, PSG can respond much faster to changing market dynamics, and improve our product development approach in emerging categories.

At the same time, we're investing in the higher growth emerging markets, and aligning our resources, development capabilities, and production capacity to meet the needs of new customers.

We have the industry's leading supply chain and manufacturing capabilities around the world, and we will make the necessary investments to maintain our leadership position.

We conducted this evaluation with PSG in an absolute position of strength. And we've confirmed that we're well-positioned to compete and win. And now, it's time to get back to business.

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

Great, Todd. And with that, Operator, we'll now take a few questions.

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## QUESTIONS AND ANSWERS

### Operator

Thank you very much. (Operator Instructions). Our first question comes from the line of Ben Reitzes with Barclays Capital. Please proceed.

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**Ben Reitzes** - Barclays Capital - Analyst

Thanks a lot. I just wanted to ask you about what your early read on the strategy is now. In September of last year, you guys threw out some figures on the margins could stay in that 5% range. And I was just wondering if, as part of HP, what is the strategy right now? Do we have the similar margin characteristics over the long term? Maybe you don't want to talk about the near term, but just, Meg, your vision over the long term, is it comparable to things you've said in the past, or is there a way to think outside the box and take this in a completely new direction? So if you could tie in the numbers and then maybe that vision, that would be great.

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

You know, I have been here just 5 weeks and have been diving into a number of different areas in the Company. And I think it's a little premature to outline the vision and what I think the long-term margin structure of the Company is. I'll let Cathie reiterate what we've said in the past.

What I will tell you is I think the opportunities in front of this Company are amazing. The people are fantastic. The assets are great. We have some tremendous assets in hardware, in our services business, in PSG and IPG, and in a number of other areas. So I'm very enthusiastic about the potential, but it's a little early for me to unveil, if you will, the longer-term strategy and the financials associated with it.

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**Ben Reitzes** - Barclays Capital - Analyst

Okay. I was talking about just for PSG, but is that the same answer?

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

To some degree, listen; I obviously was deeply involved in this analysis. It's completely the right thing for PSG to remain part of HP. And there will be margin pressure in this business. It's a very competitive business. But we're going to continue to improve our supply chain. There is room left to do better on that, which is a core competency of the Company.

Our manufacturing capabilities are second to none, but I think we can make them better.

And I also want to focus more on product development. Having the very best product that is right for consumers. Because even when we sell to the enterprise, guess who is using those PCs? They are actually people who work for that enterprise. And so with the sort of consumerization of IT, I think we can do a better job in product strategy. Cathie, I don't know if you want to comment anymore on the margins.

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

No. We are not really going to update our segment financial models on this call. As you know, though, PSG has industry-leading margins that is supported by the leverage and the scale that's across HP. And frankly, the analysis and evaluation that we just completed only confirms that again.

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

Can I sneak in a follow up? There's concern that we're losing share here in this business. And obviously the IDC numbers actually showed you weren't, but there is a concern. And is there any near-term stabilization program that you've implemented, Meg, that can give us confidence that you can stabilize this business and actually grow share over the long term?

**Todd Bradley** - *Hewlett Packard Co. - EVP, Personal Systems Group*

Ben, this is Todd. Excuse me, I'll start and then I don't know if Meg wants to add. I think clearly we've seen enormous competitive pressure, especially in light of the August 18 announcements. I think you've got to give enormous amounts of credit to our sales people for continuing to take the fight to the customer and to our competitors, and that resulted in the share gain you saw in the short term.

I think we're very conscious of pressure that the business will be under in the near term that this created, but we have a series-- first, we've got the best sales force I think in the industry to address that. Now we have a whole series of new products and other programs that will work across HP to make sure we keep the pressure on.

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

I think it's difficult to, IDC I think showed that looks like in the third calendar, quarter we held share. But it's hard to know what the sort of hangover effect of August 18 is. What is first quarter calendar year next year going to look like? We don't know. But we're going to fight for every order, and I think we're going to be back on our front foot.

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

Thanks a lot.

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**Operator**

Our next question comes from the line of Bill Shope with Goldman Sachs. Please proceed.

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

Okay, great. Thanks, guys. In light of this decision, can you give us an update on how you're thinking about your tablet market strategy, both near term and longer term?

**Todd Bradley** - *Hewlett Packard Co. - EVP, Personal Systems Group*

Well Bill, this is Todd. That thinking hasn't changed. We're continuing to focus on a Microsoft-based-- the tablet that we have and the ones that will develop on Windows 8.

I think from a webOS perspective, that's kind of the next piece of work to complete. I know Meg and I are working, Meg, the whole team of Meg, Cathie, myself, Jon Rubinstein working very, very hard and as quickly as we can to make the right decisions about that product.

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

Let me just add, I think we need to be in the tablet business, and we are certainly going to be there with Windows 8. And so we're going to make another run at this business. And we're going to make a decision about the long-term future of webOS within HP over the next couple of months. And as soon as we make that decision, we'll let you know on that.

Because many people have said to me, well isn't the webOS decision just completely tied to PSG? The answer to that is actually no. webOS is, has obviously use in the PSG business, but also in other businesses that we have. So it's actually-- we have to make a more holistic decision around webOS, which coming to a town near you soon, I hope.

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

Just to clarify your review of webOS, you mean the software, not the webOS tablet.

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

Correct, correct. The software. Right, the software.

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

Great. Thank you very much.

**Operator**

Our next question comes from the line of Katy Huberty with Morgan Stanley. Please proceed.

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**Katy Huberty** - Morgan Stanley - Analyst

Thanks, good afternoon. I assume you received feedback from a number of your large enterprise customers in the process of evaluating PSG. So just curious what the feedback was as it relates to what HP needs to do to win back support of some of these customers who were frustrated with the mixed messages over the last couple of quarters. In general, but specifically as it relates to PSG.

**Todd Bradley** - Hewlett Packard Co. - EVP, Personal Systems Group

Well Katy, it's Todd. I'll start and then I don't know if Meg wants to add on. I think it's fair to say we got feedback broadly from enterprise customers, partners, big retail partners, really around questioning the decision, understanding the strength that we had brought to the marketplace.

But frankly, the focus was on making a decision, which I think Meg led very effectively and very aggressively. And I think, I've got to, again, give compliments to our sales people who have stayed aggressive, stayed in front of these customers, continued to position our value proposition. And I think the clarity that we provided today will meet many of those, if not most of those concerns.

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

I think that's right. I talked to a number of large customers, and their feedback to me was uncertainty is not your friend here. We're a little bit nervous about making a big order for PCs, because if it spins off, maybe it's going to be great; maybe it won't be great. And so uncertainty in business is never your friend, and it's one of the reasons we wanted to bring this decision to ground.

But I tell you, it did not substitute for what I have come to understand is a hallmark of HP, which is incredibly rigorous analysis. We had 18 different teams with experts in each area who dove deep into this. And it was an impressive thing to watch on a pretty accelerated timeframe.

So I feel great about the decision, and frankly, the feedback I've already had from customers is, hey, this was the right thing to do.

**Todd Bradley** - Hewlett Packard Co. - EVP, Personal Systems Group

Thanks, Katy.

**Operator**

Our next question comes from the line of Shannon Cross with Cross Research. Please proceed.

**Shannon Cross** - Cross Research - Analyst

Thank you very much. First a question for Meg. I'm curious; are there any other sort of key decisions that have been made by your predecessor that I'm sure are not of this magnitude, because clearly this was the big one, but that you're sort of reconsidering?

And then if anybody can provide any update on your thoughts around the Thailand flooding. Just, I know you don't want to talk about the quarter, but is there anything you can give us with regard to potential impact there?

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

Sure, let me take the first one and then Todd can talk about Thailand, although I'm very familiar with the Thai situation.

So you know what I'm doing is I've got some tactical decisions. Remember what I said when I stepped up into the role was make Q4, make the PSG decision, and make sure that the autonomy integration gets off to a good start. And so those are the sort of the near-term tactical things I am focused on.

But then perhaps most importantly, come back out to the market for shareholders, for employees, for partners, for customers with a very crisp articulation of what is HP. Because I think we confused the market pretty dramatically on August 18.

So what I want to do is as soon as we can, to have it be right, come out and say what is the mission of HP? What's the business strategy? How do each of the business units' strategies fit in under that? What's the financial strategy for each division, meaning what are the operating margin characteristics, what's the cash flow characteristics? And then finally, a resource allocation strategy-- sorry, a capital allocation strategy for the Company. And it's one of my top priorities, because no matter where I go, the first question I get is what is HP?

So we're on it, and again, moving as rapidly as we can. Because again, clarity I think is our friend here, but I want to make sure we got it right and I want to make sure that the leadership team is bought in, because once we nail it, we got to execute against it consistently. So that's where we are on that.

Do you want to talk about Thailand?

**Todd Bradley** - *Hewlett Packard Co. - EVP, Personal Systems Group*

Yes, sure. I'll just touch briefly on Thailand. Clearly we're very, very engaged and working with all of our suppliers, all of our drive suppliers. First off, our concern for our employees, and frankly, the people in Thailand is overwhelming. Obviously it's a catastrophe of major proportions.

This is where one of the-- I think this is a real-life example of what validates the decision to keep our businesses together. Our ability to leverage our scale, our capabilities to drive the right solution for our customers through tragedies like this is a huge piece of what makes HP as great as it is.

So we're working this every day. I think Meg's talked to-- Meg and I and our supply chain guys have talked to every hard drive supplier in the past week, A) offered them our help and condolences, but at the same time, seek to get as much surety as we can of supply. So it's a great testament to the strength of our supply chain and the strength of our business.

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

It's a human tragedy of epic proportions over there. And I got to say I'm incredibly impressed with the contingency planning and catastrophe planning of these disk drive suppliers. They don't have a lot of options right now, particularly in the part of the country that's flooded. But they are being very creative and quite resilient.

And I think as Todd said, we benefit from our long, not only our scale, but our long-term relationships. We've been doing business with these suppliers for many, many, many years, and I think that's going to help us get our fair share, or maybe even more, of the disk drives that are going to clearly be in short supply in Q1, no question about it.

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**Shannon Cross** - Cross Research - Analyst

Thank you.

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**Operator**

Our next question comes from the line of Mark Moskowitz with JPMorgan. Please proceed.

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

Yes, thank you. Good afternoon. Two questions, if I could. Todd, you talked about the aggressive environment that HP had to participate in since August 18. I want to just get a sense in terms of the economic impact. Did you have to give away a little more goodies to your channel partners, and do you still have to provide some channel protection in the near term?

And then Meg, bigger question here just in terms of the SWOT analysis that we really appreciate you guys doing around PSG. Have you started to look at other parts of the business as well? Maybe services had a tough road the past year in terms of running a SWOT analysis, in terms of identifying ways to augment or refine that business as well.

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**Steve Fieler** - Hewlett Packard Co. - VP, Investor Relations

Hey Mark, as you know, we're going to give an update on November 21, is a scheduled Q4 earnings, so we can kind of give you the update at that time on the first part of the question. But I'll hand it to Meg to kind of answer the larger strategic question.

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

As you can imagine, one of the things I've been doing is going through each and every business unit with a complete review of strategy, as you said SWOT analysis, are there refinements to the strategy. And of course we're building our 2012 budgets. So it's been a really good opportunity for me to dive deep into each of the businesses, understand the challenges, understand the strategy. And so we're doing that exact same analysis for each of the 5 businesses. And it's going to input into the 2012 budget.

Do I wish we had a little bit more time? Absolutely. But you know what, I think I've gotten a pretty good sense. And the business units are-- these guys are really smart. We've got some very talented people across these business units.

And so with a focused analysis and focused half-day sessions on each business, I feel like we're making a lot of progress in terms of what we're going to do in 2012 and what we're going to focus on. What we do well, let's do more of it. And if there are some things we need to fix -- and you're right; ES has had a challenging time -- what can we do to make that business healthier in 2012?

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

Thank you.

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**Operator**

Our next question comes from the line of Kulbinder Garcha with Credit Suisse. Please proceed.

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

Thank you. I have just a couple of questions. My question for Todd is just on the tablet strategy, Todd, what makes you confident that having been [left] this and what led to the tablet market, and certainly by engaging with Windows now with the lead of both Apple and Android, what can make you competitive in that market quickly? Especially given you referenced kind of growth for the overall PSG business going forward, I assume tablets will be part of that at some point.

And the question I have for Meg is just more to do with we appreciate the decision being taken quickly. I guess as you looked at HP being amongst [in] now, what are the other things and announcements we should look forward to? For example, I know you mentioned that you have to make the Q4, obviously, and the autonomy integration is on top of mind.

But are there other things that shareholders have often brought up that HP to look up. For example, does the (inaudible) need a groupwide restructuring, given how much earnings have come under pressure? Do you (inaudible) and kind of other management changes? Are those other things that we can look forward to hearing, or really, we should really just expect the Q4 results and the autonomy integration to be on your priority list for now? Many thanks.

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**Todd Bradley** - *Hewlett Packard Co. - EVP, Personal Systems Group*

I'll start with the tablets. We're at the beginning stages of a new segment in personal computing. I hardly think a couple months into it that I would clarify us as being too late. I think the work we're doing with Microsoft is extraordinarily compelling. And frankly, I think the work we're doing in other categories like the Ultra-Mobile space, will be very, very competitive. It's a competitive business. It moves very, very quickly, and one we have lots of strength in.

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

I think the next time you'll hear from us will be in fact earnings on November 21. I don't think there will be any announcements between now and then, at least of any major import.

And what I'm working on now is, as we've talked about, making sure each of the business unit strategies are as compelling as we can make them. That we have a 2012 guidance that ties directly to what we believe we can do in 2012. And that we are betting on the right things.

One of my observations is that HP tries to do a lot of things. And I am a big believer in doing a small number of things really really well. Set them up, knock them down, set them up, knock them down. So Cathie and I are trying to lead a process, which is what are the real bets we're going to make in 2012? Let's do those really well and position the Company for a better 2013 and a better 2014.

And by the way, there are some things we need to do around our corporate functions as well. HR systems, some IT systems that could really help us I think in executing better in the marketplace with a go-to-market strategy and a sales strategy.

So those are the kinds of things I'm working on. Don't think there will be any other big announcements between now and November 21.

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**Steve Fieler** - *Hewlett Packard Co. - VP, Investor Relations*

Operator, we'll take one more question here.

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**Operator**

Thank you. Our final question comes from the line of Peter Misek with Jefferies & Company. Please proceed.

**Peter Misek** - *Jefferies & Co. - Analyst*

Yes, thanks. For clarification, Todd, you mentioned Ultra-Mobile. Does that mean that we should expect smartphone reentry by HP via Windows?

And then sort of a tie-in strategy here. You mentioned, Meg, the consumerization of tech. With understand a little bit when you were going through the PSG process how the cloud, or your thought process around the cloud, would fit in. Thanks a lot.

**Todd Bradley** - *Hewlett Packard Co. - EVP, Personal Systems Group*

Look, Ultra-Mobile is a notebook category of kind of sub-17 millimeter notebooks. So it doesn't have any relevance related to smartphones. And we're very focused on having a compelling suite in that Ultra-Mobile space, and you'll see that very soon.

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

In terms of consumerization of tech, what I mean by that is I think over time, employees of companies are going to want companies-- they're going to want to bring maybe their own devices to companies. That's easy to say. Almost every CEO and CIO I've talked to are very leery of that, because how do you control what's on people's personal devices? How do you control security?

So the way I think we can take advantage of this is have products that are highly desirable by individuals and highly desirable by CIOs, in which case we win-win. We provide something that big companies are delighted to buy for their employees, and the employees are thrilled to death because they have something that really helps them work and can also do a lot of the things they like to do in their personal life. So that's the way we're going to come after consumerization of IT.

With regard to the cloud, cloud is a word that's used by a lot of different people in a lot of different ways. And we have a cloud strategy at HP that is around the public cloud, helping individual companies build private clouds, being able to do hybrid delivery of systems across all different environments. So you will hear more about our cloud strategy. I know we talked a lot about it I think last March, and then maybe didn't talk about it quite so much. You'll hear me talk more about cloud as we get into the future vision of HP.

**Steve Fielor** - *Hewlett Packard Co. - VP, Investor Relations*

We will thank everyone for joining us today, and we look forward to speaking with you again on the Q4 earnings call scheduled currently for November 21. Thanks, everyone.

**Operator**

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may all disconnect, and have a wonderful day.



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