

# FINAL TRANSCRIPT

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

## HPQ - Hewlett-Packard Investor Conference

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Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

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## PRESENTATION

### **Brian LaRose** - *Hewlett-Packard - Investor Relations*

Good morning, everyone. My name is Brian LaRose and I'm with HP Investor Relations. And I'd like to welcome all of you to the IPG Investor Conference Call being hosted in Orlando, Florida. Tim Wesselman from Investor Relations is also here with me and we're delighted to have with us Vyomesh Joshi, Executive Vice President of Imaging and Printing, Pradeep Jotwani, Senior Vice President of IPG Supplies, John McMullen, Senior Vice President of IPG Finance, Larry Lesley, Senior Vice President of Digital Photography and Entertainment and Steve Nigro, Senior Vice President of the Graphics and Imaging Business.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

I'd like to remind you that this call is being webcast with details available at [www.hp.com/info/investor](http://www.hp.com/info/investor). A replay of this event will be available shortly after the conclusion of the call until the end of February next year. I am pleased to tell you that the primary purpose of this call is to provide you with information regarding our latest advances in the Imaging and Printing Group, including the retail photo solutions that HP announced this past week.

Please note that this is not a quarterly update nor will we answer any questions regarding the quarter in progress, however some of our comments and responses to your questions may include forward-looking statements. These forward-looking statements are based on certain assumptions and are subject to a certain number of risks and uncertainties and actual future results may differ materially. I encourage you to read the risk factors described in the company's annual report on Form 10-K for the fiscal year ended October 31, 2005, as well as subsequent SEC filings after our Form 10-K for an understanding of the risk factors that may affect the company's business and results.

With that as a riveting introduction, VJ and Larry will start us off today with some comments on this week's exciting news. That will last approximately thirty minutes. Following their comments, we'll begin our Q&A session with those present here in Orlando, which will last approximately ninety minutes. So with that, I'll turn the microphone over to VJ.

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**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Thanks, Brian. So, what I want to do is talk about overall IPG and then we'll focus on the retail solutions. The next slide please. So if you look at IPG and we started this journey in 2002 with Big Bang I. We are consistently growing our revenue and our profits. And the important part here is really building a long-term model that we can build core, emerging and new businesses. I think that's the one key thing that I want to really communicate very clearly. And that is based on our growth strategies and I'm going to talk about it.

The second important part is the unit growth. We need to make sure that we continue to drive our laser and inkjet unit growth because that will help us in building a model with which we can continue to grow our supplies, which will give us the capacity to build our core, emerging and new models. So when you think about our unit growth, whenever our new growth is not positive, we get into trouble with our supplies and unit stream. So for the last, starting from the second quarter of 2005, we are absolutely focused on making sure our unit growth is--best example 12% in second part of '05, then 10%, 8% and then again 12% in the first quarter of '06. The other important thing is you want to make sure we grow our revenue 4% to 6% and maintain 13% to 15% operating profit. Next slide.

So, when you look at our first quarter results, we had a really great quarter. In terms of the revenue growth, 8% revenue growth. We made 14.9% operating profit, 12% unit growth, 11% supplies growth. The thing that we absolutely feel are the key measures of our health of the business, every single aspect of that was, what I believe, very, very strong. And that's what we want to continue to drive. We want to continue to drive so that we could really build our long-term model where we know that we're going to have our supplies growth in a way that we can build the capacity to invest into emerging and new businesses, maintain our profitability in our core businesses and drive the unit growth. Next slide.

So, when we think about our growth strategies, we start with the first one saying, "We must make sure that we grow faster than the market in our core businesses." What I mean by core business is our Monochrome Laser, our single-function Inkjet. These are our--the large former design jet businesses. These businesses, we want to make sure we grow faster than the market, take the cost out. We take tremendous pride as a team that what we have done in the last four quarters, we took a lot of cost out, the cost from the R&D point of view, cost in terms of really understanding our core business from the supply chain point of view, the VSI program, the early retirement program.

We took a lot of people out. We [phenomenally] believe that is a very important step in making sure that we have the right cost structure as we move forward. The second thing we did is we identified phenomenally where we believe the growth is going to come from and invest into this growth. This is extremely important for us to have this virtuous cycle that maintaining

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

profitability of our core business, grow faster than the markets and then find some clear opportunities where we can grow our revenue and profits.

Let's talk about the first one, the digital photo and we're going to go into the details, Larry and I are going to go into the details. The next one is going after the copier pages. As we have mentioned, this is a very important market for us. We went from really no market share to 15% market share in one year. Our new product, 4730, is really accepted very well. We believe that it's going to be as successful as 4345. We are going to continue to drive our market share in the copier space.

The next strategy about the market in collateral, both in-house and with Indigo, to go after that particular market very successfully. So if you think about Indigo, over 40% growth that we are seeing in the pages. It's telling us that that market is ready for consummation and we are participating very aggressively there. The in-house piece, we have really gone with our LaserJet, colored LaserJet business, providing the web tools to do in-house marketing, very good success there. We went from \$499 to \$399 price point. Stay tuned, we are going to have major introductions here to continue to drive that color laser business because we phenomenally believe the supplies that you see with color laser, it is very important for overall supplies growth and overall of our business growth.

Grow industrial printing, this is our DesignJet business. We announced our relationship with [Seiko/Epson] to go after the very specific part of that business for the solvent-based writing system. We also read the acquisition Scitex to really make sure that we continue to grow our industrial printing business. This is where also the InkJet OEM business is very important to us. We believe this \$10 billion market is very important for our growth as we move forward. And the last strategy is the supplies piece, the after-market. We are going to continue to drive messaging and making sure that we talk about HP original cartridges because this is a very important part to continue to grow with supplies very effectively. Next slide.

So, that's really the opportunity we are talking about. We--just in the United States, 11 billion pages. And our addressable market is 12%. That market will go to 17% and the market growth is very consistent with what I talked about in terms of where the growth strategies are. We absolutely believe we are in a printing business, not in a printer business, and we want to chase the pages. The approach we want to take is where can we go and find these pages where transformation is happening so that we can drive both hardware and supplies. Next slide.

So, let's talk about digital photo now. The important part here is it's a very high-growth market as we all know that more digital cameras are sold than the analog cameras. The important thing to think about here is how many pictures are captured, what is how many are printed? Only 20% of captured images in digital cameras are right now printed. And there is tremendous growth in the captured images, but we are keeping the 20% number right now constant. The opportunity for us is how do we really unleash those 80% of the [images], which are captured but never printed? They are stuck in the hard disk. What can we do to really working with the industry in unleashing those 80% of images? That's going to be a very important part of the strategy.

Another important part of the strategy is the home printing is still growing. But the retail is also a very important part that we need to participate. And that's one of the key things that we want to talk about today. Now I want to make sure that you hear directly from me our focus in home printing is not changing. That's a very, very important market for us. We make a lot of money and we need to continue to grow that. That business is going to continue to grow at the rate of the market. It's just that we need to pay attention to the retail part of the market. Next slide.

So, when we look at this particular market and how do you unleash those 80% of the captured images? Internet is a very important part here. We absolutely believe the Internet is the accelerator in really unleashing those images. When we acquired Snapfish and now we are really -- we integrated that Snapfish into our organization, we are finding that that's going to be the key in making sure that we look at all the fundamental trends that are happening right now that we build our engines on the Internet as being the accelerator.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

One of the key learnings that we have is social networking is going to be a very important part. When you think about [myspace.com], to Flickr to what's happening, well, customers are basically saying, "I can connect with my friends and family and then share images." It's a very interesting trend that we are looking at it. Now what we need to do is how can we sell that story effectively? When we started the digital photo industry, we wanted to make sure that we fundamentally understand why people take pictures.

What's the real reason that people take pictures? And it's all about telling stories. And I can tell you personally that when I talk to my Grandma, she will tell me the story. Then we use albums to tell stories. I think we'll be able to use the digital technology to tell the stories and I think that's really going to be the way how these captured images are going to be printed.

Just to give you an example, when I did this little thing on Snapfish, to really figure out how can I communicate, this is my family, and it's very powerful. When I [carry] this thing home, it is a very different kind of a communication I can have. Or on our Photo Studio product, I can create an album like this. There 154 images here. I would never have printed 154 4 x 6. But as a book to tell that story, I am doing that. I think that's what we need to really get across in a very compelling way that you can tell your family story in a very different way. Let me go to the next slide.

Now, I want to talk about two key things that we are doing on the retail end and Larry's going to go into the details. The first one is leveraging our scalable printing technology and going after the opportunity on the kiosks. And the other one is the studio. So when we think--when we talked about scalable printing technology last year, we told you that we are going to go to the various markets because phenomenally, the same equipment set that we have for our 8254 Smart or our 3310 All-In-Ones, you're going to use the same equipment set and build a completely new printhead.

So a printhead, which goes into the kiosk is a very different kind of a printhead. And this is like as wide as 4 x 6 prints, essentially you remove the media and the printhead is stationary. That's a big deal. That means that you are going to really drive completely new applications but the cartridge uses the same equipment set, so the volume, high-volume applications of home, the power strips of the learning curves could be applied to this particular cartridge. That's going to be very, very important to really go and look at how photo kiosk markets could be completely disrupted. Next slide.

So when you look at the printhead, we are going to have the same technology driving completely two different applications. One is the kiosk that I talked about. The second one is going into prosumer markets. We believe that we can go into prosumer markets and customers can print very high quality, big [event-based] ink output with this technology. And what we are doing is really looking at a different configuration of scalable printing technology to design the printhead for our prosumer printer in another version to go after the kiosk market.

The kiosk market requires, as you can see, a billion drops per second. Remember I talked about the Moore's Law or beating our Moore's Law. So we have gone and now in very short time, more than doubled our print speed. So from 18 million drops per second, we actually went to 1 billion drops per second. So that's a big deal. Now, the reason for this innovation is getting that cost structure of very high volume with the performance, we are going to really disturb the market and bring this technology again into the home site.

Really you think about not only going after a new market and getting into completely new spaces but taking the technology to the next level so that we can continue to drive innovation in all aspects of our technology. Next slide. So the Photosmart Probe 9180 is a printer targeted for Prosumer. And the good thing here is it's a very high-usage market. These customers print lots and lots of pictures. The picture I am sending that--actually this is Tim's picture. I didn't realize I have a--in our Investor Relations organization, somebody who loves prosumer photography.

So Tim, you're going to enjoy this thing, right? But you could see that we are really targeting customers who are going to print lots and lots of ink. The price points are like reasonable, \$5.99, \$6.99 general price points where we can also make hardware margins, which are going to be important for us. This is a market where Epson was really the leader. We phenomenally believe that we can go and get some market share into this particular market. Next slide.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

So on the kiosk side, our value proposition here is how can we make this thing more profitable for the retailers? And because our cost structure, because of the scalable printing technology that we already have, because it's network, because it is self-managed, we believe phenomenally that we could offer up to 40% more productivity in terms of profitability for the retailer. That's the real key thing that we are going to offer with this kiosk. And the print quality is amazing.

So I am going to pass this thing so the kiosk output--actually, I'll pass this on. You could see my family a little bit. Okay. But basically, what we believe is this is going to really help in driving a new value proposition for the retailers. The other important part is we believe the emerging market is going to be a very important part because China, India, we can jump the curve here. This is going to be very important in that market. Next slide.

The Photosmart Studio is really an incremental revenue approach because as I talked about, either you're not going to print all these pictures that are [crashed] inside a disk unless you tell them the story. And this one, we--all our trials have shown that it's going to account for a 50% incremental revenue for our retailers, a very powerful concept, both kiosk and the Photosmart Studio.

With this, I'm going to ask Larry to talk about Photosmart in details.

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**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

Thank you VJ, and you can click to the next slide. So this is a huge day for me. And it's a huge day for everyone sitting at the table right now. But VJ's kind of--I'm VJ's one neck to choke, if you will, for the digital photography market, responsible for the end-to-end ecosystem in driving it for HP. And I think if there is one slide that really characterizes the opportunity for HP in this market, it's this one here. And what you see is the analog business, I don't think anyone would disagree, it's been dropping like a stone the last few years. And as we project out into the future, you can argue about specific numbers out into the future because they're forecasts. But I don't think you can disagree with the trend of what you're seeing here.

The important thing that--for HP is the fact that the entire red area, the digital print area, is incremental opportunity for HP because we never participated in the analog world. Okay? The other thing is that when we talk with retailers, they're looking for a partner who has the digital DNA to help them through this transformation because this is an industry-disruptive opportunity at this point and they are trying to find a way to make sure that they can make it through this digital transformation.

One thing for sure that all the retailers know is that the blue line is going down. And they're hoping that the red line fills in the valley that the blue line has created. And what they need on top of that is, again, as they talk about somebody with the digital DNA to help them through the transformation is, give me something more than just 4 x 6 prints because they don't believe--this is actual 4 x 6 print forecast. We believe this but it's not like the entire market is up and to the right. But they're looking for a partner who can come in and give them more than that. Next slide.

So, we're very proud of our heritage from a photography standpoint, clearly being the number one home photograph vendor in terms of the breadth of offerings we have, all the way from award-winning cameras to our other capture devices of scanners and inkjet all-in-one devices and even our laser all-in-one devices, through our printing lineups and so forth, very strong portfolio of products. We ship probably 40, 45 million photo-capable printers every year. It's a tremendous installed base and loyal customer base that we get draw from.

But we also knew that customers want choice. And so the example that we also use is, this past year I went on an Alaskan vacation. I came back with my memory card filled with about 140 photos. I probably printed about a dozen at home, because I honestly didn't want to take all the time to print all 140 photos. But then what I did was I uploaded them to HP Snapfish and that did--then did some fun stuff with HP Snapfish. So the idea is that a lot of the customers will in fact print in the home. They want to print in the home, but they also want to have other motions as well.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

Snapfish has been an extraordinary acquisition for us. When we acquired them back in May of this past year, I believe they had registered users of about 13 million. Now about 8 or 9 months later, we now have registered users in excess of 22 million. In December we acquired PIXACO, a company in Germany that will be our big thrust into the European market from an online photo sharing and printing website. So we're excited about that and now have presence in 13 countries with great HP solutions for our customers from an online service.

VJ showed you just one of greater than 90 different photo products that are offered on the Snapfish website and that's the photo blanket there. That's actually my personal favorite because I think it really does touch the emotions and really display and tell, as VJ says, the story of your family for generations. But 90 other photo gifts out there because people want to do more in telling their stories. In the past, it was putting photos in a photo album, maybe jotting a few words about the photos. Now we're helping people express themselves in a whole new way.

Now in retail, what we're looking for is being able to bring a lot of those capabilities that have previously only been offered online and offer it in a one-hour turnaround service in retail. And that's something that has really created a lot of buzz obviously here at CMA and also an awful lot of excitement with our vendors. Thank you, next slide. This just kind of touches again briefly on the fact that customers want to print everywhere. We do a lot of research, and we know that customers will print at home. They will print online. They will print in retail, based upon their desires at that time.

Again, if they want to do special photo products, they'll be able to do it online or in retail. If they want to be--share as fast as possible, they'll do it electronically in the online service with Snapfish and so forth. Home printing is still a very important part of our business as VJ said before. Even though the percentage of prints being printed in the home is dropping off over time, the sheer laws of big numbers, there's still about a 10% compounded annual growth for 4 x 6 equivalent prints in the home. Next slide.

This is the Photosmart Express. As VJ said, this is the--kind of the industry's first truly standalone kiosk. And the reason why we say truly standalone is that this thing has been built from the ground up to be able to be deployed in a distributed environment. If you look around today, basically the majority of the kiosks that you'll see are literally six to 10 feet away from a photo department and there's a reason behind that because the kiosks that are out there today require a lot of intervention by a photo associate. We designed this from the ground up to be truly an unattended device.

The first comment I'll make about this is that it is completely networked, both wireless or wired, if you will. And what that wired networking capability or the networking capability allows you to do is remote management. So if you are a customer of ours and you buy the kiosk and you subscribe to our service or if you're a large retailer and you want to manage it yourself, we give you the capability of literally going out and diagnosing every single kiosk on your network.

And all kinds of information comes back, very, very valuable information for the retailer, so information about the health of the machine. Now, we've got redundancy built into this to ensure that we have maximum uptime. But if something--if we start to see that some of the indications of failure are coming, we can actually deploy the service staff out there and correct the problem before it impacts the customer. You can tell when the paper is low or when the ink is low so we can send service folks out there to be able to top off the media or change out the ink supplies.

The other thing that the wired or networking capability does is enabling payment at the kiosk. So just slide your credit card through and be able to take care of all of the payments. So, no need to go up to a counter or see a sales associate to complete your job. The other thing that the network capability does is one of the things that the retailers are most interested in is, who's using these kiosks? And what is their behaviors? What are they printing out? What are the job sizes, and so forth. So, that's very good information. What times of the day are the most peak times of the day? So, all of this customer relationship management data will be available to them through our services.

And then finally, the other thing that this allows the retailers to do is to actual run real, live promotions on a targeted basis. And so they may know that there's a gymnastics tournament in [Port Alice], Oregon, and for these hours of the day, they may actually

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

run promotions to say, "Well, normally this was--who knows, \$0.19, \$0.24, but for the next three hours, come in. Bring in your gymnastics photos and we'll run a promotion down to \$0.17, \$0.19 or something like that." And then, they can get the pulse data back immediately as to how effective those promotions were, so very important.

You can also--the other important thing about this is it has a bar-code reader on it. So, the retailer can run promotional ads in the newspaper and magazines or flyers or whatever, as long as its got a bar-code on it, you can come in, scan the bar-code and enjoy the benefit of the discount or whatever the promotion is. Another example is integrating this with Snapfish. So, we'll be able to upload your photos to Snapfish and literally, I could send them to a specific kiosk across the country that might be the closest kiosk to my mother. She would receive an email with a barcode. All she does is print that out, take it down, scan the barcode, and the prints will pop out, so a tremendous capability enabled as a result of the full connectivity that we offer.

VJ talked before about kind of changing the economics of this. And this is a very important point. This is [inkjet] technology being brought into the kiosk world, and inkjet technology fundamentally has a lower variable cost of printing than dye sublimation. And dye sublimation is the--kind of the prevalent technology out there in the kiosk world today. VJ also mentioned that literally, we can offer up to a 40% improvement in profits per square foot for the retailer.

And I'm sure you all understand, the retailers literally look at every square foot in their store environment. And they calculate every product that's being sold on that floor and what's the average per square footage and so forth. So, a 40% increase--up to a 40% increase is absolutely eye-catching to the retailers because it's all about the economics. There's other things--reasons why we can offer and be able to do this is it is fundamentally a much more reliable machine.

I talked about the remote management capability of it. Also, when you look at the printhead--in fact, the printhead that's being passed around, that is the printhead that goes in the kiosk. That printhead will live or be a useful life of up to 400,000 prints. Now, the average life of a dye sublimation printhead is somewhere in the neighborhood of 20,000 to 40,000. So, your printhead life is literally--connects what you would you get in a dye sublimation.

I'm not going into all the details because I think you've got some of the information in your packets and so forth, but just incredible technology. One of the other things I will talk about is the sheet capacity. I think that's important. In our kiosk, we actually have cut-sheet media or pages of photo paper, and this is a little different. Number one, all of the dye sublimations have roll feed. And basically the problem with roll feed is, what happens when you get down to the end of the rolls?

Well, the operator has to make a decision. Do I swap out the roll and throw away good media? Or, do I let the roll run out and the customer has a bad experience? So again, any time one of our service folks are interacting with the kiosk, they can top off the media just like you would your own home photo printer. Next page. Photosmart Studio, this is another--this--the retailers are going nuts over this, because again, this is a total new, revenue stream for the retailers. This is again enabling products that have only been available online in a one-hour turnaround. And we're going to take you to the floor.

Hopefully, you all brought your images and you can create some of these books yourselves, or posters or anything. But the idea is you literally walk up to an input terminal, pop your card, your USB thumb drive or your CD with images on it, whatever you've got, pop into the machine and literally, within a 5-minute experience, you have created a photo book or a calendar or a poster or so forth. Everybody likes to show pictures of the family and kids, and I'm going to pass mine around too. So you're not unique, VJ. But this is an example of a calendar out of the Studio system and again, it gives you the 12 months at a glance.

It gives you the ability to put from 12 photos up to, I think, 80 or 100 photos, and it'll auto-populate the--in collage form, your photos. And the thing that I want you to really take an eye on is the intelligence of the HP Labs' software, the algorithms that we use to be able to take any size of a photo and be able to auto-populate it in a way that there's no wasted space. So, here's a 5-shot panorama that I took of Mount Denali. And you can see how easily it automatically populated it to make sure that I had a great-looking calendar. So, we'll pass that around.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

I guess VJ's photo books are out there. I'll leave mine by the door so you can look at my wife and kids, because they're beautiful people and all this kind of stuff. But it is extremely powerful to be able to--the experience that we get in retail is just phenomenal in terms of people going up there. One quick example of one of our store trials, we had a Vietnam veteran who came in and we didn't know he was a Vietnam veteran at the time, but he kind of talked to the people in the photo area.

He was asking questions about our new studio, and said, "Thanks a lot," went home, came back a little while later and had brought pictures of his first tour of duty in Vietnam. And he literally had not shown anyone those pictures since coming back from Vietnam. He loaded into the kiosk. He created his book. When he got his book back, he literally had tears in his eyes. He was so emotionally taken, because he was going to a reunion of the members of his company from his Vietnam company or whatever. Now, that's not--and my--that's interesting, but what's the compelling thing?

The compelling part of the story is, he literally stayed in that store for almost two hours afterwards, talking to other customers and showing other customers what he did, because he was so swept up with the emotion of the power of, as VJ keeps saying, telling the stories in this way. The first thing we see when people share--the first thing they do when they get the book is they want to share, just like VJ shared his book, and I want you to take a look at my book and so forth. The second reaction we get is the person who's looking at it says, "How did you do it, and where did you do it? Because I want to do it too," because of the simple 5-minute experience.

There is a difference with this studio product. There isn't a lot of customization with it. It's an auto-populated. You can move photos around and so forth, but you won't see a lot of annotations, because you don't really want someone standing at a kiosk for an hour creating a photo book. You want a quick, 5-minute experience. Online, you can take the time at home and do all kinds of annotations and stuff like that, get a photo book delivered to you in a couple of days. But if you really want the fast turnaround, we've got a 5-minute experience for you. So, I'll pass that around.

There's other things you'll see, poster collages on the walls behind you over here. Again, from one picture all the way up to, I think--is it 100--I think the books are up to 200 and I think the posters are up to 80 to 100 or something, but literally creates some really remarkable collages and personal artwork, if you will. Next slide. Again, VJ showed--this is just the growth rate in the retail side of the business, just to quickly show you that there's an awful lot of growth there.

The orange is the growth rate in the retail kiosks. The green is the minilabs. So obviously, the announcements that we have right now are really taking advantage of the growth in the orange at this point, but also remember on top of that growth rate, because it's the first in the industry and nobody can forecast it at this point, is what's going to happen in retail with enabling these 1-hour turnaround of photo-gift products, phenomenal upside for the retailer, phenomenal upside for HP in this market. Next.

Another thing that we understand is that not only do customers want choice, but retailers want choice. And so, we have some very flexible business models around how we deploy our systems. So from a kiosk standpoint, we have both a sold model, we'll sell you the model or we'll lease it to you. And we'll sell you the service contract with the supplies replenishment and all that kind of stuff, or we'll actually have an HP-placed or what we call a revenue sharing.

So in some of these alternative markets where they just don't have any experience with photo, and they don't want to do a whole lot of investment in photo but they believe that there's a lot of folks coming through their area with images, we'll have a place models that results in a revenue share. So HP will own and maintain the kiosk, but the person--the--whether it's a cruise ship or a hotel lobby or an airport or whatever, they'll get a revenue share, if you will, of every print that comes out of that kiosk. Next.

So again, VJ talks about how powerful the Internet is. What I want you guys to walk away with is again, the comment I made at the very beginning. Who in this industry has the digital DNA and breadth of offerings and technology to satisfy the complete ecosystem with digital photography? There's only one company I can think of, and I'm a little biased, but I believe it's HP. And

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

that's what the retailers are looking for in terms of a partner that they want to help them through this digital transformation. I'll take the last slide.

So our big announcement this week, obviously we're very excited about our retail photo announcements, the Photosmart Express kiosk, the Photosmart Studio that's designing their--enabling this 1-hour turnaround of photo gift products, our expanded portfolio of professional photo printers. You're going to see the 9180 is just a spectacular B-size or 13-inch by 19-inch photo printer that is absolutely extraordinary. I wish you all could have come to the Analysts' or Press and Analysts' Lunch we had yesterday, because we had a couple of professional photographers who got up and talked about the impact that this printer's having on their business, if you will, and how much they value it.

At TES, we introduced a bunch of new cameras. We've got seven new cameras in our lineup. We're very happy that DIMA selected our 927 as a product-innovation award. It's our high-end camera that we're introducing this year. It's got a lot of great features. We'll show it to you in the booth, a beautiful 3-inch LCD display on the back, and it introduces our next-generation of real-life technologies, which are these easy-to-use features that traditionally, prosumers have enjoyed but we're now bringing it down to mass-market price points.

And my favorite real-life technology feature that we're implementing in this particular camera is called a slimming feature. Literally, you take the picture. It'll save the picture the way you took it, but if you go into preview mode, you can click on slim and literally, it'll give--do two versions of slimming. It takes the person in the middle of the photograph and makes them a little thinner, which I think is kind of an awesome--given that I've kind of put on a few pounds in my older years here.

We got the DIMA innovation award for the 927 camera. We also got it for the Photosmart Studio. And I think that's incredible, because here is a new product, hitting the market, the only one of its kind at this point, and we're acknowledged from the get-go as having one of the most innovative products at CMA. So with that, I'm going to sit down and we'll--I'll guess we'll entertain questions.

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**Brian LaRose** - *Hewlett-Packard - Investor Relations*

At this time, we'll open it up to Q&A. If you have a question in the room, please raise your hand.

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## QUESTIONS AND ANSWERS

**Cindy Shaw** - *Moors & Cabot, Inc. - Analyst*

Hi, it's Cindy Shaw with Moors and Cabot. If you could talk a little bit about switching costs for a retailer that might have another solution already installed, any sunk costs they might have, any contracts they might be locked up in, really, what will it take to get into a retailer?

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**Larry Lesley** - *Hewlett-Packard - SVP of Digital Photography and Entertainment*

That's a great question. First on the Photosmart Studio, completely new business, incremental, all they need is the square feet to put the equipment in. So, there's no contractual things they have to worry about. From a kiosk standpoint, these contracts I believe are usually kind of like three-year contracts. And so for all of the retailers, these things come up for renewal. And so, we're planting the seeds for those people who have contracts today to basically say, "When your contracts come up for renewal, look what we can do for you.

If you'd like to exit your contracts early, we're more than happy to help you as well." We're also going to folks that may not have photo business today. And that's why I talked about the fact that the kiosks are truly standalone, remote devices. They can go

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

where people have not had photo departments before. So grocery stores and convenience stores and things like that are places that you'll be seeing the kiosks.

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**Cindy Shaw** - *Moors & Cabot, Inc. - Analyst*

And then if you could talk to the complex part of it where what you're trying to do is help the retailers find a way to convert digital images into print, that 80% that's not getting printed, what you've found out so far with your pilots? Are you--are they selling a lot of blankets that they might not be selling otherwise--?

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**Larry Lesley** - *Hewlett-Packard - SVP of Digital Photography and Entertainment*

Yes.

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**Cindy Shaw** - *Moors & Cabot, Inc. - Analyst*

And things like that?

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**Larry Lesley** - *Hewlett-Packard - SVP of Digital Photography and Entertainment*

So right now, again, the photo gifts that we're doing in the pilots are all pretty much hard-copy devices today. They're the posters. There's the photo books, the calendars, greeting cards, even little small pamphlets that are great. The retailers look at this, and this is really the entry position. For \$4 or \$5, you can create a great little booklet. And I'll pass these around because I think they're kind of cool too. Greeting cards and burn a CD of it, so those are basically it. What you're seeing is I think in some cases, up to a 50% uplift in their photo-department volume as a result of this.

I'll tell you one other quick thing. And actually it kind of shows when you go in and you test something, you don't really realize what you're going to find. But in one of the stores, the guy who ran the frame department all of a sudden saw a huge stock-out of his poster frames. And he had no idea why, because they had great data to show the seasonality of posters and all this kind of stuff. And he thought he'd guessed purchases right.

But he didn't know that we had implemented the Photosmart Studio and because of all of the posters that were flying out the door, he stocked out on his frames. So, it's another important thing for the retailer is, there's an attached uplift associated with these new products as well. When you get something like these posters and now you get the value of selling frames associated--along with them, incremental revenue, incremental profit in attached.

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**Frank Timmons** - *Robert W. Baird - Analyst*

Yes, thank you, Frank Timmons from Robert Baird. You talked about giving customers flexibility, I guess from the channel. And if you look at the data, you see home use still growing but kind of changing where you see the big growth coming in online and also in retail. And then you see the later adopters actually looking for more simple hardware at Windows in their home. I'm just curious from a business-model perspective, what are your thoughts on the different takes on profitability in all the segments? Does it matter for you? Do you see one more high-use, [so], details there?

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**Larry Lesley** - *Hewlett-Packard - SVP of Digital Photography and Entertainment*

Again, the important thing is customer choice. If you tried to confine a customer to your to your particular business model, I believe you will fail. Ultimately, you have to offer customer choice. And so now, we're enabled to offer it in-home, online, in

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

retail, the best of all worlds, if you will. We can't go into the economics of every one of those flows. But needless to say, just as VJ runs an overall IPG portfolio, I run an overall IPG portfolio of photography solutions. And it's a very healthy business, and we're excited about being able to participate in all.

The other key thing is that Internet thing is very important, because again, being able to keep those images alive, who knows where those images will be printed. And the example I use is we talk about it as the velocity of images. The more people who see the images through sharing, the more chance that that image will end up in a print somewhere, whether it's in retail or whether or not my mother-in law, because I emailed it to her or used Snapfish to send it to her, whether she printed it on her home print. So what we're all about is the ease of use that you talked about of sharing and getting the velocity of those images up.

And there was thing that I didn't mention before, but there are really two revolutions going on in photography right now. The first one's well under way and that truly was the transformation from analog to digital. But my controller, who actually is in the back of the room here, Janice, she coined the next revolution. And she says, "You know what the second revolution is? The Internet mom is regaining control of the family memories."

And that's very powerful, because you think about the analog day, who took the most pictures? Who created the photo albums? Who was the keepsake of the memories? In the first phases of the digital transformation, the I-mom was lost, because she wasn't the target audience. It was more the text-savvy individual and so forth. And so a lot of those images, probably more than 80% were hidden on the hard drive. Right?

Now, through the ease of use work that we're doing in the home, the ease of use work in online and the simplicity of a 5-minute experience in retail, we're now giving the power back to the Internet mom who doesn't have a whole lot of time, but cares very much about sharing and preserving family memories.

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**Tony Sacconaghi** - Sanford C. Bernstein & Co. - Analyst

Thank you. It kind of feels a bit like the Price Is Right ringing in here, Tony Sacconaghi from Bernstein. I have a few more follow-up questions on the photo kiosks. I saw the announcement today about the 50 placements in Wal-Mart and Sam's Club stores. Can you give us a sense of, and I know this is basically a new product introduction, this is the debut, but are those really the only placements to date that HP has secured in stores?

Can you comment on what you believe the install base of in-store kiosks is in the U.S. today? So, is it 10,000 or 5,000? And ultimately, what do you believe the target number of appropriate kiosks is for a country like the United States? I'm sure you've done market research before you rolled out a product like this. I have a few more follow-ups.

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**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

So, certainly I can talk about some of those questions, but not all of those questions. First from a clarification standpoint, what you saw in the press announcement today with Wal-Mart is the Photosmart Studio, which again is the 1-hour turnaround of photo gift products. And we're expanding that to a 50-store trial. We also have trials with Longs Drugs, which is a regional drug chain as well.

So, we're getting some great information on that. Clearly, this is kind of our coming-out party, if you will, in terms of telling the world about this. And we've got a huge, huge response here at the show. We have other customers obviously in the funnel that we're working on setting up trials with them as well.

On the kiosk side, we've got trials going today with Albertson's, again, a grocery chain, if you will. As an example there and there's a few others that I don't have in front of me. From a forecasting forward, we really don't release what our goals are in

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

the market and so forth because that--all I can say is this is all incremental business for HP. And so, it's a huge upside for us. I don't know if, VJ, you have any other comments on it.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

No. I think main thing for us, Tony, is really partner with the retailers. I think the important part here is [arrear] your partner and find other incremental revenue opportunity or changing the profitability model and the better off we'll be. So our approach is, we are going to focus initially in the United States, and then we'll go global, because I think there are opportunities outside of the U.S. also.

**Tony Sacconaghi** - Sanford C. Bernstein & Co. - Analyst

I just have a couple of follow-ups. Can you comment on Walgreens and [inaudible], you're involved in that business, and if not can you comment on--or if you, can you comment on why you didn't secure that business? Because obviously that was a very significant deal.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I think, you know, you're not going to get everybody signed up right away. With Walgreens we do have a relationship with Snapfish. I think what we--we need to do is as Larry talked about our ecosystem plays very important. We want to participate at every touch point where the customers are, so even in the home and online, online to retail, the retail is a couple of these things.

And I think we are finding different places where we are connecting, so like Costco and Snapfish, Walgreens and Snapfish. We are using Snapfish infrastructure for a lot more even globally. So I think, the approach we are taking, we are saying, okay where we can make a contribution. And it's not going to be overnight. You know we always talk about new business launch and then learn and then lead. And I think we're in launch phase.

**Tony Sacconaghi** - Sanford C. Bernstein & Co. - Analyst

[inaudible] comment at all about--I know you outlined the economic plans for the kiosks. I presume that most--I mean if I was a retailer I would go for the HP placed plan particularly given your [strategative] learn I think, you know, retailers are probably like that, are of that same mindset. Let's try it no risk. You know we'll HP to substantially own and operate the kiosk. Can you give us any sense of expected economics under that scenario? What kind of capital investment is required in placing a kiosk by HP, and what might be a general sense of the revenue sharing agreement behind that?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

We aren't sharing this information right now, Tony. I think the important part here is we thing that this will become a very important part of the business moving forward. We honestly believe long term that inkjet technology has capability to replace silver halide. And we fundamentally believe that we need to build our portfolio so that we will be able to make that happen. It's not going to happen overnight. We need to really drive all these solutions in [parallel] and improving the technology from scalable printing technology to really understand how we can [unleash] images to the online assets that we have.

This is kind of a really long-term strategy. I think the vital limits are coming into place. The really important part is the retailers are very interested, because they see digital really hurting their business because of the film development part of the value chain that disappeared. So what they are saying is, "Wow, can you help us in growing?" And this convergence is happening, gaining [households], in gaining more revenue, more profit. I think that's the approach we're taking.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

So this industry has been really very constrained, by only very few players and the solutions were also very limited. Everybody was talking about 4 x 6. I think having a different conversation is absolutely helping us in getting the foothold that we need and the retail partners.

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**Richard Chu** - *SG Cowen & Co. - Analyst*

Yes, hi Richard Chu from Cowen. A couple of things, following on just the point that you were making with respect to ink ultimately displacing silver halide. I wonder whether, we may be mixing paradigms here because I think all of us certainly believe that digital displaces analog. There's no question about that, black and white. But whether that implies that ink displaces silver halide or ink displaces dye sub, which is really the issues at hand is a different matter.

So I wonder in speaking about the market opportunity of 50,000, 100,000 installed kiosk out there, you have effectively zero footprint. I'd like to go back to a variation of Tony's question which is how do you--how do you visualize your success in establishing that proposition? Because ink is going to be ultimately king, 5, 10, 15, 20 years from now. Either, are you going to be a 10% share player in kiosks in a few years? You talked about the difference in variable cost, value proposition, you didn't expand on that at all. Can you tell us what exactly is the variable cost advantage in the ink-based kiosk over a dye sub-based kiosk today?

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**Vyomesh Joshi** - *Hewlett-Packard - EVP, Imaging and Printing Group*

So let me ask Steve to make some comments on the comparative between dye sublimation and ink.

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**Steve Nigro** - *Hewlett-Packard - SVP, Graphics and Imaging Business*

So I'll try to take that in two parts. So first off today the variable cost of printing let's say in a kiosk versus dye sub is lower with ink. It's basically you're looking for ink immediate cost. Long term as VJ said we really see two keys to our target of eventually replacing silver halide. Number one is get the quality. And we already believe we're there on the quality side so we've already cleared that hurdle, and quality I mean not only the photo quality, the durability, the permanence etcetera, which is an advantage we already have today over dye sub. So second is to get that variable cost of print down.

And there's numbers out there but we're saying we want to get, if you look at silver halide costs it's about \$0.08 to \$0.09 a square foot on fundamental costs. Now we're not there today, but for us to achieve the goal of basically meeting silver halide that's the sort of cost per square foot we'll need to get down to with our technology. Now we don't have that today but it certainly is something we can do--we can do it. It's just a challenge now for us to put those pieces together, the quality, the permanence, and the variable costs. So we can do two out of the three today but in the future it's getting all three.

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**Unidentified Audience Member**

[inaudible question-microphone inaccessible]

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**Steve Nigro** - *Hewlett-Packard - SVP, Graphics and Imaging Business*

That's the--.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Well I think, I think there is no question in our minds as to our technology being better than that. Because you see they have it--.

**Unidentified Audience Member**

[inaudible question-microphone inaccessible]

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Yes today. I think your donor sheet and you have a roll feed and a lot of aspects of dye sublimation technology that from a permanence point of view to actual cost point of view we'll be doing better today.

**Richard Chu** - SG Cowen & Co. - Analyst

And just following on the--.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

All right, yes.

**Richard Chu** - SG Cowen & Co. - Analyst

[inaudible question-microphone inaccessible]

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Units per hour.

**Richard Chu** - SG Cowen & Co. - Analyst

Per hour, do--you think that there's significant scalability to that speed based upon [inaudible]?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Well this is our first--.

**Richard Chu** - SG Cowen & Co. - Analyst

[inaudible question-microphone inaccessible]

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

If you remember Richard--if you remember Richard years ago when I said we would beat Moore's Law, we could have been at 36 million drops per second. Now we are at billions.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Richard Chu** - SG Cowen & Co. - Analyst

[inaudible question-microphone inaccessible]

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Not 6 years ago, 2002. And yes well, I think that design was very different. Our focus was very different there. I mean we did multiple heads. Here this was single head, you know, supplying that kind of prints per hour. Steve, anyone?

**Steve Nigro** - Hewlett-Packard - SVP, Graphics and Imaging Business

Yes it's--if you look at it today you have minilabs which will do something in the order of let's say 1,400 to 1,500 prints in an hour, right? And minilabs can be upward around 70K. So I mean you're already looking at a photo kiosk that's dramatically below that and it's about 700 prints. And you don't even have to get very sophisticated, let's think if you just replicate that printage in twice and parallel and you already have this sort of throughput of a minilab without--already [inaudible] is going to be lower cost. And that's just a very kind of straight forward buy two sort of approach.

So there's no doubt that we'll be able to get to the higher throughputs. That's--that's not even a question. It really, the key will be our ability to get the higher throughput and to continue to drive the variable costs down because that's ultimately going to be--drive the economic model for us and for the retailers.

**Shannon Cross** - Cross Research - Analyst

Shannon Cross, Cross Research. A couple of questions, one on the kiosk, and then one on Indigo. With regard to the kiosk I'm just curious, again digging a little deeper, how you're going to basically push out Kodak from their significant install base? It's got about 70,000 kiosks worldwide and are you willing to say, let the retailers co-brand?

I actually heard different things from different people in the HP at a show floor yesterday, so I'm curious as to whether or not you'd let retailer co-brand? Because again, right now you have 4 x 6 printing but you don't have 5 x 7 or 8 x 10. So obviously you're going to give them a better margin or you're just not going to charge them anything to begin with and give them a check every month. But what other things can you do?

And then of the install base you're looking at building how much do you think will be sort of a replacement for an existing kiosk that's probably somebody else's brand or it definitely is, and how many will be sort of Greenfield new places? I mean Fuji threw out that they wanted to go to Lowe's and Home Depot, which I thought was kind of a stretch, but--.

**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

Okay so again I'll go back to VJ's comment before about launch, learn and lead. So, don't have a lot of answers for you in terms of the forecast moving forward. But the--I'll kind it put it this way, the retailers are looking for someone new in this space. As VJ kind of said before, there have been very limited choices among the folks that have the digital DNA to help them transform in this industry. And as a result how do we dislodge?

We dislodge through offering better services, better products and so forth. It's an overall relationship management between us and the retailers. And clearly we are pretty popular with the retailers given the strength of our home printing base, if you will, in terms of the number of units we move through their stores in terms of printing devices, cameras, scanners, PCs, storage devices, etcetera, etcetera, etcetera. And a gazillion units of supplies that we move through those channels as well. And we have built very strong relationships with them, and they have been anxious for us to enter this space.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I think the other important part is different distribution, not just where they are, the competitors are. But because it's self-serve, because the labor content is much lower, I think we are going to find very different distribution partners who are going to be really interested in going after that. And then in the emerging markets I firmly believe that we have a phenomenal opportunity because infrastructure is not there and you can really jump the curve. So I think that's what you will think about. I think having the ability to really claim that you could be 40% better profitability to start with is a very, very important value proposition that we could have over the distribution front.

**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

The other thing I would finally add to that is the fact what I'm most excited about is the Photosmart Studio from the standpoint of some of those major accounts that may be locked in at this point because they're not locked into taking this incremental revenue and profit opportunity. But we get in there and we do a great job of servicing that account and showing them what we can do with Photosmart Studio products, I firmly believe when the contracts come up for renewal that we'll have a wonderful shot at displacing whoever in there with our kiosks.

The other important thing is the relationship we have with a lot of these key retailers in terms of our online presence. Again we power over 30 co-brand sites, other people's online photosharing websites with our Snapfish assets. Very powerful in linking home and retail through that Internet online experience.

**Shannon Cross** - Cross Research - Analyst

[inaudible question- microphone inaccessible]

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I mean we share information, everything today.

**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

Right.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

What we want to share.

**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

But what we can share is what's in the press release.

**Brian LaRose** - Hewlett-Packard - Investor Relations

Shannon before you ask your Indigo question let me remind everyone in the room if you could please make sure you speak into your microphone when you're asking questions. Thank you.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

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

Is that at me?

**Brian LaRose** - *Hewlett-Packard - Investor Relations*

That was general.

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

With regard to Indigo I'm just curious how far you can take into photo printing? You talked a little bit about it, but just in terms obviously it's used for the photo books. Is there any thoughts of bringing it down making sort of a minilab or I don't know, if Best Buy wanted to have a distribution plant where they'd print out all the pictures is that possible at this point?

**Larry Lesley** - *Hewlett-Packard - SVP of Digital Photography and Entertainment*

Well anything is possible, right. So the first thing--the first thing I'll say about that is along this line of how digital and digital photo exchanging it actually turns out in our latest quarter and VJ talked about the greater than 40% [case] growth year-over-year in Indigo presses. We actually have the ability to pretty much know too the impression of what's going on in all our presses. And several specialty applications, things like the books etcetera, actually now are some--in last quarter out of our five largest accounts two of them were photo specialty applications, which hardly were even on the map two to three years ago.

So first off it's really clear this is an exploding area just not in retail but also even on--in our Indigo business. So photo specialty is definitely a great opportunity we see for our Indigo business to continue to grow. And given the leading quality position we have with Indigo because it is a liquid EP solution, we feel that sets us up well because at the end it's still going to be about quality. It's again it's going to be variable cost of printing but quality will also be important.

Now in terms of taking that and going all the way from photo specialty to photo finishing is the part of your question, that is certainly possible. I mean if you look at the digital press technologies out there. I think of all the--the real high volume whether it's LEP or [inaudible] I think it's definitely--it's very doable.

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

You have that right --I know a commercial [front] trade show I was at, Indigo was printing out photos as one point.

**Larry Lesley** - *Hewlett-Packard - SVP of Digital Photography and Entertainment*

Sure, sure, and so again it's the exact same equation. I was talking to Richard it's all going to come down to you have to get that whole combination of quality, the image, attributes, permanence and then the variable costs. And then, of course, the variable costs will be even actually quite low for an Indigo application because it will be in some sort of regional or central sort of position. So we're not going to comment. I'm personally not going to comment on whether we are given that or we're not given it. But what I will say is it's certainly within our capabilities of doing.

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

It's Brian Alexander with Raymond James. Just a couple of kiosk questions, is there any way you could point to any customer satisfaction studies whether it's third-party research or even if it's anecdotal existing retailers, that are you using your competitors'

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

products just because it seems like you're very confident that upon expiration of some of these three-year contracts you'll see some meaningful expansion at least on the Express side of the equation.

The second question is it also seems like or maybe the question is, how critical to your overall growth strategy on the kiosk side is the adoption of these machines in non-traditional formats? I think you mentioned cruises, universities, airports, etcetera how critical is that to the overall growth strategy?

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**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

Okay Brian, I don't really have any anecdotal information that I'd like to share about the customer experiences of our competitors. We traditionally don't--don't talk about that. And in terms of our strategy, in terms of how critical it is for the non-traditional channel it's kind of a balanced approach if you will. Our goal is to go where the photos are today, right? And so that's with some of the key partners that we've already talked about. And we're--we're pushing hard into that space. But we're also looking at the same time some of these alternative channels, and it is--it's a launch, learn and lead kind of a situation at this point.

Now if you want to get anecdotal information about H--people have used the Express when you're walking around on the tour most of the--most of the people with HP shirts down there who are next to those kiosks actually have been in stores talking to customers and getting feedback. So when you're walking around you can talk to them and hear what they have to say, what they heard from customers.

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**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I think [inaudible] yesterday. Do you have a quality you can sell? And I can tell you we have a quality that can sell. And I think that's--every day the other features are interesting but in my mind, no. We are a kiosk which generates a print which we can sell.

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**Andy McCullough** - Credit Suisse First Boston - Analyst

Thanks, Andy McCullough, Credit Suisse. A broader IPG question, VJ, you talked about in the strategy extending the value of HP supplies. How is the after-market threat changing in the core business, and I guess what are you doing differently to combat what seems to be an evolving risk?

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**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I'm going to ask Pradeep to answer the question, Pradeep.

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**Pradeep Jotwani** - Hewlett-Packard - SVP, Imaging Printing Group Supplies

The after-market competition has been there for as long as we've been in business. It as business grows and as the market grows there is more and more of the after-market competition. I think of them in two parts. I think of them as the manufacturers typically selling us private-label from different suppliers as well as the refill kiosk we're trying to offer service where people come in and bring in their own cartridges and have them refilled.

The reality is that there's a great deal of technology. There's a great deal of innovation in these--in our cartridges. The reality is that the market is moving more and more to where regular draft or regular text documents are being read off the laptops, and what people are printing are higher quality things whether that is photos or whether that is marketing collaterals or whether that is business documents or whether that's digital fine arts and things of that nature. So people are getting more sensitive to quality.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

And so then, if you look at the kinds of reliability that we offer, our reliability is dramatically greater than our competition quality Logic desk service, and you can see that something like one in six of the remanufactured cartridges actually fail prematurely. If you look at the retail shops something like 60% of the retail cartridges had problems. If you look at the quality of the output, the quality of the output that we have is dramatically better.

In fact, [Henry Williams] says that he hasn't found anything in the retail market that has more than a five-year life. And what is happening frankly is that people are making the trade off. Some people are buying from the competition as they always have because of smaller price. But most people have a value need and so our market shares in the after-market are basically stable, and I feel fairly good about it, but it's an ongoing battle. You find us continue to make high quality stuff. You find us continue to innovate. You find us continue to make sure that we communicate the value of our brands, our launching of the Vivera sub-brand and the ColorSphere's [ingredient] brands was part of that communication activity.

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**Bill Fearnley** - FTN Midwest Securities - Analyst

Yes, Bill Fearnley, FTN Midwest Securities. A couple questions here on kiosks. How do you folks measure success here for the kiosk for this year? In terms of what type of ramp do you expect? Do you measure success in a large install base here in '06 or, at the end of the year you're going to say we have a lot of tests with a lot of large resellers and we really expect this thing to really ramp in the out year? So how, just a question on that how you measure success here in 2006 and then a follow up as well?

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**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

Yes so success is--again go back to launch, learn and lead. We don't talk about the future forecasts and so forth, but literally we want to move through these trials as fast as possible and then scale. And so our biggest challenge this year in '06 going into '07 is how fast can we scale in North America and then how fast can we start globalizing after that? So as VJ said we'll start first in '06 focused on North America and then we'll start globalizing from there.

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**Bill Fearnley** - FTN Midwest Securities - Analyst

[inaudible] running the traditional retailer so I'll ask the obvious question about the PC retailers. When--when should we be expecting you folks to be doing anything or you do you have anything planned for those folks here in '06, the Best Buys, the Circuit City's, some of the regional guys that are active in certainly your printer category, your PC category and your cameras as well? Thanks.

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**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

And again I can't talk about future business. I can talk about press releases that we've announced today, that's it.

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**Bill Fearnley** - FTN Midwest Securities - Analyst

[inaudible] again because most of the focus of the discussion of your press releases, to defer to your press releases, it's been mostly retailers and I'm just curious when should we be starting to think about then anything in the computer retail space? Should we expect it this year or do you need to digest the retailers this year and go into those guys next year?

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**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

It's a who knows at this point, right?

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Sherri Scribner** - Deutsche Bank - Analyst

My name is Sherri Scribner from Deutsche Bank. I just wanted to ask a few questions, you mentioned your competitive advantages in the kiosk market. How do you see yourselves comparing with the minilab market in terms of cost performance and how are you competitively attacking that market, trying to get your kiosks in there versus minilab?

**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

Steve, do you have any data on versus kiosk?

**Steve Nigro** - Hewlett-Packard - SVP, Graphics and Imaging Business

Well I mean they're very--I'll say something and Larry you can add. I mean they're very different markets, right? I mean the minilab is quite a different solution. It's a behind the counter sort of solution that is--it's higher volume so it's--the whole of idea of kiosks is a couple. It's about being able to give the consumer a chance to interact directly, the choice directly, and it's actually quite different economics as well. I mean when you talk now I quoted some numbers on a minilab and the cost associated with that but you need to get a fair amount of volume on the minilab to make it work in your retail establishment.

A kiosk, which is designed for a totally different daily usage actually allows these devices to go broader because you can actually have it work economically at a lower daily usage. So it's a lot of questions about how it's all going to play out, but definitely I would say the minilabs is kind of stuck in the middle piece between kiosk which will really serve this--this lower, lower duty cycle, more distributed sort of placement versus of course then you've got--still have some central fulfillment who charge the lowest, barest possible for the solutions out there. So very different almost product categories I would say.

**Juan Seymour** - Merrill Lynch - Analyst

Thank you, [Juan Seymour] Merrill Lynch. I had a question and I was wandering the floors of [PMA] and saw that--I saw your kiosk over there and went through a trial run and it's got some fascinating software on there which allows you to touch up your photos and do other stuff. But in the process of doing so you can actually spend a fair amount of time just standing at the kiosk doing all these fancy things, and your prints are literally printed pretty fast. So do you think that you will adopt an order station kind of approach, I mean is that we should expect as the next generation, I mean can you give us some sense of product road map here? It seems like the print--the printing itself takes a lot less time relative to the time you actually spend at the kiosk so from a retailers perspective?

**Steve Nigro** - Hewlett-Packard - SVP, Graphics and Imaging Business

He's asking are you going to separate it basically into terminal from the printer?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I think it will all depend on what the customers want. What we are basically saying that if most people ways to do this thing behind the counter, right at the kiosk. I think you are asking a very good question, the productivity of the kiosk based on how much they want to change could be different and are we going to do separate--?

I think that's what we are really figuring out doing the trials into separate activity. We can--that's a very simple configuration issue rather than [fundamental] architecture of the platform issue.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

The other thing I'll add to that is we're continuously revving the software in terms of trying to understand how to make the experience faster, if you will, because we know that people don't want to wait in lines and so forth. A lot of the retailers are actually kind of going to what I'll call like an Internet cafe-type environment where they'll actually have multiple of those terminals around in more casual environments so people don't feel like they're having to stand in line.

They can do some of the projects and so forth. But that was one of the things we really focused on this studio thing with this 5-minute experience was we knew we didn't want people spending an enormous amount of time trying to create a photo album. I think we've been very successful with that. I think the current experience with both of those softwares we're continuously revving for ease of use and simplicity.

**Steve Nigro** - Hewlett-Packard - SVP, Graphics and Imaging Business

So I'll peak your curiosity when you're walking around [inaudible] look around and you might get some sort of an indication, some answer.

**Juan Seymour** - Merrill Lynch - Analyst

Quick follow-up. And some of the competition has also recently introduced I guess a [initiative] where you can just drop off digital media at retail locations and have that processed. Any thoughts around that and how cannibalistic that might be to a kiosk market?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Well I think, I think what you're asking me is this whole market is a \$30 billion market and [you're] a sub segment of the market in some sort of kiosk, minilab, centralized and by region we have very different--like in Europe there is much more centralized printing than on-site printing. So I think we really need to look at globally this market and characterize what are the real tier value proposition that we need to offer versus what other competitors are offering.

Our approach is very focused because we can't do everything. We need to--this is a new market for us. This is something that's completely new incremental revenue for us. So we are really saying, okay where can we make unique value proposition which will work for--that's why we chose kiosk because we know that it's still a lot of 4 x 6 printing done at a very high volume, low cost what kind of unique value proposition we can have.

Now the other place we saw there was nobody really looking at the creative projects and the retail environment, can we do something there? So that's where we are starting and how we merge and how we really go after the whole market, that's a very--in our mind--a long-term question. Of course we said we found really two key places where we can have unique value proposition and it's kind of the strategy that basically says lynch pin and really figuring out once we succeed there then we kind of grow. We can't really go after the whole market. We need to be very clear, very strategic about where we want to go.

And I think we can make a value proposition deal work. I think that's sort of where departments are staying and slowly then we need to grow. That's what I--we call, launch, and learn and then we--I think we can explore under the whole market.

**Matt Troy** - Citigroup - Analyst

Matt Troy, Citigroup. I was wondering if you could just talk about the learning curve in terms of how you demonstrate ROI for the channel? I think about selling a kiosk it's a very simple, break even at X number of prints be they 4 x 6 or 8 x 10 and the need

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

for asking to open up the Studio it's more of an open up a business than a business. There's the square footage angle. There's a labor angle so I would liken it to one selling someone a Coke machine and two asking them to open a snack bar and a restaurant. And then two if you could quantify the market opportunity if kiosk is 100% from a channel perspective is the opportunity 30% of that for Studio, give some color on that? Thanks.

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**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I think you're asking us more than what we know really. I'm not going to be very up front, right, because we just don't--we [wont] tell you something, we aren't smart enough to right now to really tell you that but we understand exactly the question.

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**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

Very well characterized--I think if you could characterize the selling [motion] and what it means to retailers, excellent. And again it's why we talk about expanding a trial with Wal-Mart, right, in terms of we're together trying to understand the seasonality of volume with these products and so forth. Trials with kiosk will go very quickly, right? Because it's more of a tried and true, if you will, a known commodity in terms of looking at economics and doing ROI and all that kind of stuff. So it's out there. Like you said, that's we're expanding trials.

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**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

And you know as you I and talked about yesterday the 60 prints is kind of a break even point for dye sublimation. We have our own numbers. You need to just test them out and make sure that it becomes very clear to the retailers, say wow there's opportunity of improving the profitability by 40%. So I think we are very, very focused on that, and that's what we want to--. But the good thing is the technology that we are deploying with is a very stable, very high volume low-cost technology so that's the power of it. So we know at what cost structure that we can really achieve. Now we've just got to make sure that we can implement that into the retail environment and drive the feasible profitability --.

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**Unidentified Company Representative**

[inaudible], you've got a question.

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**Tony Sacconaghi** - Sanford C. Bernstein & Co. - Analyst

Yes Tony Sacconaghi, Sanford Bernstein. A couple of follow ups if I may, VJ you talked about the long-term goal for the group is to grow revenues at 4 to 6% and operating profit at 13% to 15%. What's the unit number in your minds that you need to grow to achieve that targeted level of revenue growth and profitability? You said you wanted to grow faster than the market which I sort of thought was curious because the market is growing at 12 bursting one year and growing at zero another year. Would you really want to grow faster than the market both years? You've got to have a--a unit number in the back of your head that you think is needed to drive the market?

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**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I think the unit number is really for the core businesses.

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**Tony Sacconaghi** - Sanford C. Bernstein & Co. - Analyst

The vast majority of your business right now like 90-plus percent.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I'm sorry.

**Tony Sacconaghi** - Sanford C. Bernstein & Co. - Analyst

But that's 90-plus percent of your revenue in that?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I won't call it 90%. I think we [have] a better portfolio than you are giving us credit.

**Tony Sacconaghi** - Sanford C. Bernstein & Co. - Analyst

But that's not how we define [inaudible].

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Okay that's what you're saying, okay, but what I'm basically saying is I think the way we think about it is, and I think this is a very important part of IPG, is to really understand our core emerging and new business portfolio. Because the model that we have is going to be very important for us to really have that confidence with which we are saying that we can drive this business 4% to 6% from a revenue point of view and maintain 30% to 50% operating profit.

What I mean by that is, we model very clearly for the next four years what we think that supplies, revenue and profits that we are going to have. Because that's a very important part of our equation. The second thing we need to understand is what investment you will need in the growth strategy that I talk about so that we can generate the revenue that we have. So those three elements, from the supply/revenue stream will give us confidence and capacity that we can drive our unit growth and our investments into the new businesses. That will tell us what revenue and margin growth that we can achieve from this business.

So the unit growth number we are really making sure that the supply/revenue stream that [assumption] that we want to make is going to be valid for us. And the growth strategies allow us to really articulate to you with a confidence that [inaudible]. Because it's very important for us to grow not just the digital photo but the copier market and the graphics market and industrial market. So all these things together is going to generate 4% to 6% of the revenue growth. So I think the unit growth is just one variable. It's not the variable in terms of really looking at our business. I want to make sure I'm very clear about that.

**Tony Sacconaghi** - Sanford C. Bernstein & Co. - Analyst

[inaudible] if you wouldn't characterize it as a unit growth maybe you could characterize it as over the next two or three years, because it's a dynamic equation, what contribution to growth is coming from the core business versus your emerging business? Is your core business, call it 80, 90% of revenue, driving 4 points of that revenue growth and the emerging businesses are driving 1 point of that revenue growth? Or how do you think about that model, and again it's going to change over time.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Well I think--I think the important part is the core business is not also static, right, as you said that as we go into the all-in-one business or the color laser business part of that will become what we call, what we define as part of the core.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

The way we think about that is we need to maintain or improve profitability in our core business, so that we could fund our emerging and new business. So that's a better thing to think about our core business rather than the revenue growth. It has to provide more profitability so we could fund our emerging and new business. Emerging business is the one which will drive the revenue growth because that has the capacity and capability--that's where the market is in tornado mode where we could really build our revenue engine.

And the new business is an opportunity that we believe long term can generate both revenue and profit. So think about core business providing more than average profitability for IPG, emerging business really providing that revenue engine that I'm talking about and the new business is where we know two or three big opportunities that we have that we can invest into this and drive the profit engine for the IPG.

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**Tony Sacconaghi** - *Sanford C. Bernstein & Co. - Analyst*

[inaudible] from the growth side you've done a lot of small targeted acquisitions in imaging, is a billion dollar plus acquisition possible in the Imaging Group?

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**Vyomesh Joshi** - *Hewlett-Packard - EVP, Imaging and Printing Group*

Well I'm not going to say what --.

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**Tony Sacconaghi** - *Sanford C. Bernstein & Co. - Analyst*

[inaudible] what do you define parameters on the side of an acquisition?

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**Vyomesh Joshi** - *Hewlett-Packard - EVP, Imaging and Printing Group*

Yes I think--I think what we want to do is really make sure that the fundamental growth strategy we have, we have capability to drive that and accelerate that growth. Wherever we have gaps we're going to do that position. I can't tell you small or--.

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**Tony Sacconaghi** - *Sanford C. Bernstein & Co. - Analyst*

You have no boundaries or guidelines, I mean [Mark] said repeatedly we shouldn't really expect a large acquisition and the kinds of acquisitions that HP's been doing are more suited with his aspirations.

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**Vyomesh Joshi** - *Hewlett-Packard - EVP, Imaging and Printing Group*

I think I'm very consistent with what Mark is saying.

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**Frank Timmons** - *Robert W. Baird - Analyst*

Thanks, Frank Timmons again from Baird. It seems intuitively to be successful in digital media and then as you moved on part of the equation seems to be having great media or paper, if you want a really high-quality image, but a glossy piece of paper or media is something you want to keep in your house more or whatever. I'm just curious maybe this is--VJ you talk about having this--does HP have a unique opportunity for any value composition? So maybe your thoughts on a) is media or paper something you think is a big opportunity and secondly are you uniquely positioned, do you have that value proposition?

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

So I'm going to make a couple of comments and I'll ask Pradeep to make more comments. You know media is an extremely part of this equation. It's not just for the photo, but when we go after market in collateral, when we go after the industrial we need to print on multi-media. And we have core chemistry, core competency in HP from ink point of view and from media coatings point of view. We will continue to drive that intellectual property because we phenomenally believe that the profit pool that we have opportunity is as much on ink as media and we need to continue to drive that. And that business is, of course, growing rapidly for us. And maybe Pradeep you want to--?

**Pradeep Jotwani** - Hewlett-Packard - SVP, Imaging Printing Group Supplies

So the media business is a good solid business. It tends to get lost in the size of about \$15 billion, [inaudible] size is overall, but it's a multiple hundred million dollar business. We are--our focus is very clear. Where we can do our printing on plain paper we work with others to a plain paper commodity providers. Where there is specialized graphics, photo marketing collateral brochure kind of applications, where the application is special and to get that particularly good application our coatings and our chemistry are useful, then we have IP there. We work with other people to put our intellectual property as part of their middle processes and we actually sell media.

Now that has been certainly photo and the photo it used to be home photo paper and we had a variety of grades for it. As we move into the market for advanced amateurs or consumers, and in fact in the digital fine arts it's increasingly also canvas and art paper and watercolor paper so the stack holds space. In addition to that space there is a whole space beyond photo and that is, for example, as you go into the word growth strategy of marketing collateral to actually make paper which works well as a brochure is--has particular characteristics in the paper that we have. And so marketing collateral brochure paper is another growth area for us.

And lastly wide format paper whether it be for posters or whether it be for other graphics applications is a large opportunity. I should add on top of that then the kind of applications we're addressing with our Scitex applications, the Scitex acquisition are a huge opportunity for paper. So you should think about our media business as being one that is targeted, not just the commodity paper, substantial and growing at high rates.

**Unidentified Speaker**

[inaudible microphone inaccessible]

**Pradeep Jotwani** - Hewlett-Packard - SVP, Imaging Printing Group Supplies

Oh yes, intellectual property does matter. We have, I mean clearly I mean by strategy I would say if it isn't intellectual property, if it is basically plain paper which I'm sure you've seen HP branded plain paper in stores that is license model. So we have revenue and profit and it's very good because we have a fair amount of that. But-but that's not our core emphasis in terms of what--where we invest and where we sell at the value model.

**Steve Nigro** - Hewlett-Packard - SVP, Graphics and Imaging Business

The total kiosk would not have been possible if we hadn't made--and we made some tremendous innovation in the ink side of the equation with a new self-disbursing pigment inks technology. We have some new technology in the media as well. It would not have been possible just by working on half the equation.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

So I think that's a very important point for market share retention for suppliers. Because as we go faster and faster from the speed point of view as we develop new pigment inks and new media people when they refill their ink they're not going to get the same results. I think there are a lot of fundamental innovations we are doing in terms of the speed, in terms of quality, reliability, are going to become the barriers in terms of having quality and reliability from the refill and re-man ink manufacturers.

**Unidentified Audience Member**

A question of dye sublimation versus inkjet. I kind of intuitively understand why it's cheaper, inkjet is a less expensive alternative. Can you give us more specifics just so we understand a little bit more, is it in the manufacturing of the media that thermal gets more expensive on the supply side? And then I think there are just sort of more invests on the hardware side is that fair?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Well I think there's [inaudible] on the hardware side and you have donor sheet and you have--it's a lot of fundamental technology differences. Just think about plus the power that you need to provide to the head to transfer that. Basically you are feeding the dye with sublime onto the donor sheet. So I think these things are fundamentally technologically explainable differences. The color range is also different, permanence is different.

**Unidentified Company Representative**

[inaudible] it's not a paper size sub printer. You put plain paper through it and you get any transfers. So the media has a lot of constraints on it to have it work in the system. You can take plain paper, pump it through an inkjet burner and get pretty good looking output. So basically the design constraints on the media for on an inkjet is not near as stringent as on dye sub and that's one of the knobs in terms of the media which is half the equation, of course, and then ink basically you put ink where you need to put as opposed to having a donor sheet and a lot of waste in the system.

**Unidentified Audience Member**

And then regarding the color printer, [inaudible] address this, what are the usage patterns that you're seeing color laser as you sell a 399 or 299 printer, and what are your concerns with regard to ultimately making them somewhat disposable because they cost 400 or 500 to fill them up?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Well I think the color laser jet is a very different usage profile because it's still used a lot in small-end micro businesses. And for the small-end micro businesses that's a primary printer that you are using it for--and especially when you think about emerging markets, when you think about ISC, China, India where there's a tremendous infrastructure building. Small businesses are really and they're using that laser jet even higher usage sometimes than what we would expect in a Western market. So I think color laser usage profile is very different than the inkjet usage profile.

**Unidentified Audience Member**

Okay and then a final question just in general. What are you seeing in terms of the competition out there? We haven't really asked that yet.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

In terms of the laser.

**Unidentified Audience Member**

No just in general, Canon, Lexmark, where are your concerns? You probably have an idea of where you're not concerned.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Well I think our first quarters are very different I think compared to the other competitors. That's a start point in my mind. The second thing I would say is it's not different than what we saw during Christmas. There is no real action we have seen. It's different by country, by segment, but not really a global change in the competition.

**Unidentified Audience Member**

[inaudible] but you have I think you said \$15 billion pricing. [inaudible]

**Pradeep Jotwani** - Hewlett-Packard - SVP, Imaging Printing Group Supplies

You know we don't break that out Richard.

**Unidentified Audience Member**

[inaudible question- microphone inaccessible]

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I really think it's incremental because we are still seeing our 4 x 6 media growth which is really the good way to look at how we are doing in the home printing business.

**Unidentified Audience Member**

[inaudible question- microphone inaccessible]

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Yes?

**Unidentified Audience Member**

I don't know how we define it but it's pretty good.

**Unidentified Audience Member**

[inaudible question- microphone inaccessible]

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Sorry?

**Unidentified Audience Member**

[inaudible question- microphone inaccessible]

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Yes, yes.

**Unidentified Audience Member**

[inaudible question- microphone inaccessible]

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Yes I'm just talking about the home photo printing part is growing 10% from our assumption here from 2006 to 2010 and it's still very valid.

**Unidentified Audience Member**

[inaudible question- microphone inaccessible]

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Yes, yes.

**Unidentified Audience Member**

Maybe you could comment in terms of what the real market, the real global quality kind of market potential [inaudible].

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

So you want to ask how we do we breakdown that \$59 billion into segments, sub segments? You're talking about this slide?

**Unidentified Audience Member**

Yes I'm talking about [inaudible].

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Oh here, oh I see.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Unidentified Audience Member**

[inaudible] when you set the size of the initial photo printing market the largest part of which is home by the home definition is [inaudible]. The definition you're using here is 4 x 6 [inaudible].

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

No, no this is not--.

**Unidentified Audience Member**

[inaudible]

**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

4 x 6 equivalent, all media sizes if you will I believe that's what these digital prints forecasts are.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

No, no what we are basically are saying they're more of 4 x 6, 8 x 10. With 8 x 10, a unit of 4 x 6.

**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

But it is images on either plain paper or [inaudible].

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Plain paper or [inaudible]. Okay so I think you're asking a fair question but we are not breaking it down right now.

**Unidentified Audience Member**

[inaudible] that seems like a reasonable question.

**Pradeep Jotwani** - Hewlett-Packard - SVP, Imaging Printing Group Supplies

You know I won't answer that but it is--it is a--it's a material amount obviously. The thing that is confusing here is things have changed over the last two or three years in terms of what people print on. People are starting to print photos a lot on plain paper because photo media was expensive. Over the last year and a half photo media, the lower photo media has come in at much more objective prices and people are increasingly printing on--their photograph instead of plain paper on photo media. It is net-net so that's what the price number is somewhat. But is net-net a growth business for the home as the 10% references. It is net-net a 19% growth business for overall digital photos. And so it's good stuff.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Bill Fearnley** - FTN Midwest Securities - Analyst

Thanks I'm Bill Fearnley, FTN Midwest Securities with a follow up. Just to go back to the last earnings call, Mark talked a lot about investments. You talked a lot about investments VJ here as well. When you look at product development, staffing, R&D, marketing that type of thing, when you look at increased investments here in '06 and when you look at a couple of years from now as well, where are your priorities for this increased investment? Where would it--where would the bulk of it occur?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Well I think it would be really following the growth strategy that I talked about, so we will take R&D actually going down into our core businesses because we fundamentally believe that those businesses we need to take our R&D down, but invest into photo, into the market collateral, industrial printing, that sort of growth in investments will be. We're aligned with the growth strategies.

**Bill Fearnley** - FTN Midwest Securities - Analyst

But would you be shifting research and development dollars from the core business to these new businesses, or would you be taking research and development dollars from those core businesses and shifting them into product development or is it really a little bit of both?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Well I think we feel that overall R&D is to stay flat. I don't think that we want to increase R&D. We want to just align R&D dollars more towards the new businesses. I think that's--that's what we meant by when we did fundamental things with the cost structure we didn't want to really take the R&D up. As though the revenue is growing we're still going to drive the R&D flat because that's the best for the business.

**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

Well if it's in the IPG transformation the other thing that VJ's been very clear with everyone on his team is he wants more for his R&D dollar as well. So when he says I'm going to take R&D dollars down that's an accurate statement. What he's also expecting is and I want more for my dollars. So it's not as though we're defocusing, if you will, from some of the core home or some of the core office. We're still going gang busters. We're just working much more intensely on our internal processes to get more effective with the R&D dollars.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

And that sort of platform strategy we introduce every quarter.

**Unidentified Company Representative**

It's the same thing over--.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

We see, yes so the scalable technology that [inaudible].

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Steve Nigro** - Hewlett-Packard - SVP, Graphics and Imaging Business

That's the whole idea. That was the point of the promises of scalable printing technologies is that we could make the platform investment and it would allow us to for relatively on a historical basis roll out new platforms based on this technology and I think we're seeing it, right?

And so you're seeing the pace of what we're bringing and the breadth. And it's really going out to some dramatically different markets, coming out at a very fast pace. It's not like we're actually increasing our spending in these areas. We're actually decreasing them and it's because of the leverage of scalable printing technology. So if you look at that dye right here for instance it's basically--there's a few subtle design differences. It's basically the exact same printheads that's on the 9180.

It's the exact same and in fact it's pretty much the exact same printhead that's on the OfficeJet K, OfficeJet Pro K550. So I mean it is something that we do a few designs. There's a few architectural design changes in the fluid chambers to deal with the different inks but it's that sort of leverage. And so that's how you get the productivity. I mean it's real. I mean it's just not something we're kind of conceptually talking about.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I think if you about when you're done, [inaudible] get the cost structure right, bring the cost structure down actually, come up with some fundamental platform innovation so that we can get time to market and going after the various markets you know in a really very, very productive way, and then really focus our resources where we think the growth is.

**Unidentified Audience Member**

Hi a couple of questions on scalable print technology. One, you really got product tuned to the market about third calendar quarter of last year. If you can give us a read now on basically how they're doing, two markets, one more the photo market? The other more the laser jet and the office type market replacement and then a follow up to that?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

So I think our introduction has gone very well. If you think about it the way we look at that is our ASPs versus competitors' ASPs when you think about go from 2005 order 2005, and you will see very different results. And I think that's really the power of new technology. When you introduce a new technology you're bringing that kind of a performance at \$199, \$299, \$399 kind of price points. What we are seeing is at those price points actually our units, unit growth has really flourished. And that tells you the success. That's how we measure it. And the second thing is different technology now in regard our kiosk and with you know less than seven months, we introduced the kiosk. And stay tuned because this is -- we're not done yet.

**Unidentified Audience Member**

And that completes my follow up which was there was some question about why not a broader set of product in the photo and small office market with scalable print technology. Was that because the efforts have been focused on things like digital photo?

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

The thing that we want to do always with a new technology is to find the right kind of price point, where we can really show the value of throughput and the value of the ease of use. But now once you introduce the technology a lot of places it can go. It can go down. It can go up. It can go to different markets and that's what you can expect from HP.

**Shannon Cross** - Cross Research - Analyst

I have a question on your commercial print business. Oh Shannon Cross, Cross Research, sorry Brian. The, Kodak is saying that they've been extremely successful with NexPress and they think that they've taken share from both you and Xerox. I'm curious as to whether your--your numbers would sort of indicate that would be the case and then I've got a follow up.

**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

Well our numbers would indicate that Kodak NexPress has gained market share but we have not lost share.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I think this market is--every quarter is different. So I wouldn't take one quarter number and feel good or feel bad about it. I would just look at 12-month numbers and when you say how things are going. Because there's so small numbers that you can get easily say one way or other. Our view is let's look at our page growth. How many pages are really growing? And if you're growing 30, 40%, faster than the market than you're doing good. If you're not you're not doing good. I think that's very simplistic but a much better approach to look at this business.

**Shannon Cross** - Cross Research - Analyst

And can you talk a little bit about the opportunity for inkjet and commercial printing, industrial printing applications etcetera and what you're seeing there?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Well I think we feel that inkjet has a place both thermal inkjet and [inaudible] inkjet into the industrial printing. From [inaudible] stuff that's why we acquired Scitex and our integration is going really well on that side. And on the thermal inkjet side where the DesignJet business is very solid we need to just continue to drive where it makes sense. I think as we--I'm sure you heard about our announcement at the Sundance Film Festival. We feel very, very positive about the opportunity that we have into this particular market.

**Steve Nigro** - Hewlett-Packard - SVP, Graphics and Imaging Business

Yes I think the other thing I'll add is with the acquisition of Scitex, with the exclusive partnership with Seiko Instruments and then with our own DesignJet product line up we actually now have built from a wide format portfolio the complete portfolio. So if you look at the industry today there's players, small players here, there but I mean HP we've built a portfolio such that if you're anywhere in any of these applications that, you can either at point-of-sales and high quality outdoor signage, HP has a leading solution. And we have a broad range of technologies behind it. So we're pretty much able to address the market.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Okay, Paul?

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**Unidentified Audience Member**

I'm curious on what your thinking is with respect to how the existing intermediaries, the kiosk players who are using dye sub technology in many cases or other variants of that, how you see them evolving given your beliefs about the advantages [inaudible].

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**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Well I'm sure they will definitely look at what they need to do to maintain their market share. But I think that what we view as long term, the success will come from the technology which can give them both quality, reliability and the profitability. So think they're going to respond differently.

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**Unidentified Audience Member**

Do you think that Kodak ultimately will lose to [inaudible]?

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**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I don't think that it would be possible for some of them because they don't have the technology base so I can't comment on that.

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**Unidentified Audience Member**

[inaudible question- microphone inaccessible]

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**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I think I'm always surprised by how much, how long an old technology can stay into the market so I don't know how to predict that.

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**Unidentified Audience Member**

[inaudible question- microphone inaccessible]

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**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I think Canon has the technology. My view is Canon has a very good inkjet technology. I just don't know if they're going to venture into this particular space. What we hear from retailers is they have a limited success so it all depends on what their aspirations are. But I really believe, truly believe in my mind and our mind, that Canon has a very good technology.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Unidentified Audience Member**

Hi, [inaudible] Bank of America. You talk about the three target markets that you're addressing home, office--or online and retail. Five years from now where do you see the market emerging? Do you think it's going to be at the home with your--with your photo printing line or more on the kiosk end or more with your Snapfish?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

Meaning me, meaning HP?

**Unidentified Audience Member**

Yes.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

HP would participate everywhere. That's what our basic strategy calls for. Because we see the market just like what we are showing in 2010 and we want to be on the [inaudible]. Now clearly Home we are leading. We're going to continue to lead. Online we are leading. We're going to continue to lead. Retail, we'll see how it all works out.

**Unidentified Audience Member**

And then just a quick follow up, you talk about some of your competitors in the kiosk market like Kodak. They're coming from the perspective of being a film company first and transitioning over to photo printing or through the kiosks or dye sublimation. You're coming from the perspective of being a printer company moving into the photo segment. Can you talk a little bit about your marketing strategy and trying to maybe perhaps overcome some of the advantages they might have from a branding perspective with [inaudible]?

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

I think the good thing for us is we are coming from basically saying this is absolutely incremental for us. So we are going to prowl more customers than Kodak because we have everything to gain and nothing to lose. Number two, so we are going to really attend to the customers. The customer meaning both end user and our partners.

The second thing I believe that when the shift happens, the shift happens fast. And the places where it is shifting the industry is where our assets are. We are a digital company. HP is a digital company. So the marketing is moving in where our strengths are so that's another very important part. There will be more customers entering the market. And the third thing is I think we have a technology with which we can provide the unique value proposition so all comes in from the customer point of view, end user point of view, and the partner point of view. That's where the market is shifting and that's where our value proposition is. So it's kind of a really nice thing for us. It won't be easy but it's a nice thing for us.

**Brian LaRose** - Hewlett-Packard - Investor Relations

At this point we have about 5 minutes left in the call so we ask that everyone has got a question [inaudible] we'll get through as many as we can.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Frank Timmons** - Robert W. Baird - Analyst

Frank Timmons again from Baird. Larry we started our conversation off earlier today, you talked about one of the gating factors to capture versus print seemed to be simplicity or ease of use, and I think out into the market you see digital growth, camera growth slowing. You're seeing growth actually in the camera phone segment specifically like I think in Japan there are actually more camera phones than actual stand-alone cameras. I'm wondering if--are the unique challenges or barriers to print with that form factor and if so, what are your thoughts on how you might address that?

**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

Again, it's a great question and it's a great opportunity at this point. Because you're right, more and more images, in fact one of VJ's slides here shows, the first bar chart is on what was used to capture it. And so you see the green part I think is camera phone. You see out there in the future a huge percentage that's going to be captured with cell phones. So we've been working for the past few years, in fact, we helped create the mobile imaging and printing consortium that was all focused on how do we make it easier to print from cell phones.

So the first big area of work we did was with Bluetooth technology to be to enable just in essence escorting images out of your phone to our HP printers and so forth. That's the key thing and also being able to do that with our kiosks and so forth. So that's one of the key things but also we're working with the handset manufacturers, the carriers, the chip manufacturers, if you will, all through that cellular ecosystem to try to build ease of use capabilities into that, whether or not it's downloading from Snapfish onto your phone. Whether it's escorting up to Snapfish or going to a particular device. There's a lot of work we're doing at this point. I think in the booth you'll probably be able to see some of the Bluetooth printing capabilities. Okay?

**Tony Sacconaghi** - Sanford C. Bernstein & Co. - Analyst

Tony Sacconaghi from Bernstein. When you introduced the scalable print technology there was some obvious advantages which made it great for high volume users. But I think even you explicitly cautioned that you wanted to be careful about driving this too low-end because it had some potential disadvantages. One, the ink was a lot cheaper and so it's deflationary. The second is the decoupled printhead and cartridge bay opened you up to more remanufacturing.

And I think when you introduced the product you started at \$199 price point and up. VJ's left the room but he said, "Oh well we can take this up. We can take this down." Does your thinking about some of those concerns, moving it towards the low end changed or, am I over-amplifying the significance of those concerns, that if you drive it too low end it is potentially deflationary and you do run the risk of remanufactured supplies? So I don't know, Pradeep maybe you want to take a shot at from a supply's perspective. Anyone else can chime in.

**Pradeep Jotwani** - Hewlett-Packard - SVP, Imaging Printing Group Supplies

I think you're reading too much into the statement. We mostly with scalable printhead technology we are in fact pushing on what it provides us best which is this incredible performance, speed, and a great deal of time to market for new applications. So what you're seeing us do is fill out. We started with the photo. We, a few months later we added the OfficeJet Pro K550. We are adding the retail. We have also now added the graphics [B-size] printer that you spoke about. So we're actually filling up the additional markets that we can address, which to a great extent are incremental with their technologies so I think you're reading too much into it. So what are you going to do.

**Unidentified Audience Member**

[inaudible question- microphone inaccessible]

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Pradeep Jotwani** - *Hewlett-Packard - SVP, Imaging Printing Group Supplies*

Yes the question he was asking was, since you said SPT we could take it sideways, we could take it up, we could take down, he says oh gee, are you taking down? It said you're reading too much right now. We are mostly taking it to additional markets.

**Tony Sacconaghi** - *Sanford C. Bernstein & Co. - Analyst*

So the concerns that either made up or over--I interpreted from your initial launch, R&D is a potentially valid consideration in thinking about the [inaudible], or am I overstating this a bit into those considerations? Steve now and Pradeep from [inaudible].

**Steve Nigro** - *Hewlett-Packard - SVP, Graphics and Imaging Business*

Well I think it comes down to at the end of the day you have to start with the need of the market and the customers. So I mean if to put a product out sort of performance that you need to have a leadership position let's say in a \$99 printer and the economics are favorable towards an SPT sort of architecture where you separate the silicon then that's the best answer.

So I mean we're always looking at that equation. But it's complicated, right, that some of the factors you're talking about, after market is also what the customer needs and it's also our costs and how we've come down on the cost curve. So we're very aware of all those factors in terms of making decisions. But at the end of the day you need to have the leading position in the market to be a leader.

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

Brian Alexander, Raymond James. Shifting gears you said a unique copier growth initiative. Just an update on the 4345 in terms of where were you in market share for calendar '05? You've talked about in the past the cost of the hardware is about a third of the comparable cost of the copier machines. When you factor in the total cost of ownership including supplies and service now that you've had over a year under your belt, what do you think the cost savings is for a customer factoring all that in?

**Vyomesh Joshi** - *Hewlett-Packard - EVP, Imaging and Printing Group*

Sure so I think as I mentioned earlier although market share has gone from like nothing to 15% for 2005 this is global. And again IDC information will come out soon to confirm that number. In certain geographies actually we have exceeded 20% so we feel that the value proposition that we talked about in terms of having one-third the price point in overall total cost of ownership, 30% savings is coming out okay. That's what we are really basically seeing in the markets. The approach we are taking also with our distribution strategy is also working. And the new color product, the 4730 that we introduced is also getting tremendous traction. It's just only three months data but we believe that we are going to see some real market share gain in that particular segment of the market.

**Unidentified Audience Member**

[inaudible] similar to what you're seeing on the mono side?

**Vyomesh Joshi** - *Hewlett-Packard - EVP, Imaging and Printing Group*

I think it will hold but for monochrome is definitely because the color side a lot of assumptions because the click [channels] are different. But we think that it will hold even on the color side.

Feb. 27. 2006 / 2:00PM, HPQ - Hewlett-Packard Investor Conference

**Larry Lesley** - Hewlett-Packard - SVP of Digital Photography and Entertainment

Last question?

**Unidentified Audience Member**

Yes [inaudible], I wanted to talk about seller channels as you enter into new territory it's great to say Wal-Mart or Walgreens carry their ink and our paper but there's potentially a different person making decisions about photo kiosk and photo studios. The same thing as you go into commercial and I think you ran into some of that with copiers a few years ago.

**Vyomesh Joshi** - Hewlett-Packard - EVP, Imaging and Printing Group

So I think one of the key things that we are working on as we go after this new growth opportunity we need to develop our go-to-market models because our traditional go-to-market models are not going to work in some of the opportunities. So what we are doing is we are systematically investing. So when I talked about our cost structure that we are improving the way what we are doing with R&D in terms of go-to-market actually we are investing in the go-to-market.

So we fundamentally believe that we need to drive some new go-to-market models as we go after this new growth opportunity. And the approach is very similar, you know, places where we had our core businesses we are really questioning what kind of investments we need from a go-to-market point of view and then can we really--the resource allocation can we do it differently so that we could drive more investment into the new approaches from the go-to-market point of view. And I think Mark--Mark also talked about that this is going to be a very important part for the investment, not just for IPG, but for overall HP.

**Brian LaRose** - Hewlett-Packard - Investor Relations

Thanks VJ. For those of you listening on the Web that concludes today's portion of the event. I'd like to thank VJ, Larry, Steve, Pradeep and John for their time. Thank you for your time. We appreciate it and thank you for listening.

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