FINAL TRANSCRIPT

Thomson StreetEvents℠

HPQ - Hewlett-Packard at Deutsche Bank Securities Technology Conference

Event Date/Time: Mar. 13. 2006 / 12:05PM ET

CORPORATE PARTICIPANTS

Bob Wayman
Hewlett-Packard - EVP, CFO

CONFERENCE CALL PARTICIPANTS

Analyst
Deutsche Bank

PRESENTATION

Analyst - *Deutsche Bank*

Good afternoon, everyone. For our lunchtime speaker today, I'm very pleased to have Robert Wayman from Hewlett-Packard in attendance today, Bob thank you very much for making the trip down here to sunny Miami.

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Good to be here.

Analyst - *Deutsche Bank*

The format is going to be general Q&A, I figured I'd start with -- call it 20 minutes of prepared questions and then I want to turn it over to you, the audience, to get your questions for Bob, as well. Clearly, Bob, a big part of the story at Hewlett is the restructuring program. Maybe a good place to start is to give us an overall update of the restructuring. How is it going so far? How many heads are out? What's the incremental cost savings to the model and the timing of that?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Sure, I will keep it at a high level and you can ask for more detail if you're interested. We announced in July two kinds of major actions. One around head count reductions, about 15,000 people that we intend to reduce over a period of about a year. We are about 6500 people into that as the end of Q1. That's roughly on plan. If I remember right 1800 of those were taken out in the first quarter itself. We don't have the full savings from that piece. But the 4700 or so before that, we of course see the full savings at this point and maybe half the savings in Q1 for the next piece.

We talked about overall cost savings of the total actions of around $2 billion. And about half of that falling to the bottom line. So, you can do the math if you look at all that. We're seeing oh, 100 million, maybe a little bit more of quarter B savings at this point in time. It will grow each quarter going forward. Another piece of it is the benefit plan change. Particularly the U.S. retirement plan. That showed up substantially in Q1 and will now show up completely in Q2. And that's part of the overall number that I'm talking about here. So we're moving well into it.

Having said that look at those numbers, our operational improvement is much more than that. It's coming from a variety of actions which I'm sure we will get into when we get into the Q&A. But if you look back at the history of our quarters, we actually started seeing real improvement in Q2 of last year, then Q3, and none of the restructuring savings were Incorporated yet at that point. Now we're continuing to execute on a number of areas that we think are driving the improvement both top line and bottom line and in addition getting the benefits of the restructuring.

Analyst - *Deutsche Bank*

Maybe you can help us understand where the 15,000 heads are coming from? Why won't this impact your ability to grow, your ability to provide good customer service, et cetera?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Sure. First, I should say that when we talk about restructuring 15,000 heads, that's how many employees we are going to pay -- we expect to pay to lead the Company. Some of those employees will be replaced by other employees, in many cases in different lower cost geographies. So ultimately there is no impact if we do this right on customer service. So, that's point number one. And certainly the sales force, while we are doing some sales management cuts overall, the sales force is getting a very small share of the overall cuts.

The majority of the head count reductions are in what we call the functional or horizontal areas. IT is the largest, but it includes IT, finance, human resources, legal, some marketing functions, real estate, people who support our facilities. And, again, this 15,000, even in those areas, we may be taking head count out and then outsourcing the activities. We don't expect a fundamental change in service level, but we do expect a change in our cost level. So there is a difference between the growth savings and the net bottom line savings. All of that is incorporated into the guidance that we gave you back in July.

Analyst - *Deutsche Bank*

So, when we think about the timing of the incremental restructurings, what's the biggest variables in that timing? What determines -- how many heads are taken out in Q3 versus Q4 versus Q1?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Yes, there's really two key drivers. One is the legal environment or labor law, labor regulatory environment, which is mainly present in Europe. There is a few Asian countries where you also have to work with unions. So that definitely affects the timing. We have made good progress in Europe. And we are started in those countries. But in negotiations with the employee workers councils, as they're called over there, the negotiation may say, okay, we agree you can remove X-hundred people, but we want it spread over three quarters. So that's part of the overall negotiation. So we would expect most of Europe -- most of the world to be done by the end of the fiscal year. So that's one point.

Second point is the readiness. As I said, in some cases we are changing the location of people, we're moving to back office functions to India, Costa Rica, Eastern Europe, et cetera. You have got to hire those folks, train them for three, six months before you can take the costs out, so, you're actually doubling up on the cost for a little while. Not usually a very big cost, but it does take some time.

Analyst - *Deutsche Bank*

There's been a lot of news coming out of Europe one way or another. It looks like a lot of political noise to me. Is there anything to report incremental one way or the other as to how those negotiations are going?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

The negotiations are going in the vast majority of the countries very well. And noise is a good term. Reality is people understood that in France, for example, we've got a lot of pushback in the government and then the press, but it wasn't a week or two later until the government was realizing that this wasn't helping their image as a country to be inflexible and so things are going okay.

Analyst - *Deutsche Bank*

Moving on to the drop down rate, you talked about $1 billion of expected savings hitting the bottom line, versus 2 billion in total. Can you provide us any color of where you're going to invest that incremental $1 billion? And by that I mean, what segments in particular offer the greatest growth opportunities for Hewlett-Packard? What's the key strategic priority in terms of investment going forward?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Sure, when we say drop down to the profit line, it's not only investments, it's pricing actions. It's all kinds of different things that might represent the difference between that gross and net to the bottom line. I'm not going to give you a lot of detail. First, the 2 billion to 1 billion dollars or the 50%, it's an assumption. We're talking, -- at the time we made this announcement, we were talking about what would the state of the Company be 18 months forward. So it's clearly an assumption. But it would include, certainly there are businesses that we do want to make more investments in. You just -- some of you saw just last week, the rollout of our photo kiosks.

You don't get into that that kind of a business where you have entrenched competitors without making investments. R&D investments, marketing investments, tooling investments, and ultimately business at a loss for a while. You're not going to make money in the business day one because you are investening in it. So it's those kinds of things. Certainly, again, a couple of others in imaging and printing. We have been very successful in our multifunction printer space, increased our market share substantially. We're up to mid-teens sort of market share. That's fine. But we're used to 40% kinds of market shares in printing. That's our goal. Again, we are going to be spending money on sales resources, marketing -- marketing development funds and all sorts of things to drive further into that kind of business.

If you look in some of the other businesses, PCs and industry standard servers, areas which we will probably get to in a moment, but we've made very good progress and profitability in those businesses and I will give you some reasons for it, but, we probably need to make some investments. Be it in pricing, be it in additional go to market resources, et cetera. In some cases we have lost a little market share and that's okay. That's the trade-off we intended to make. But as we get our cost structure done, we are going to be able to be more aggressive and that's the kind of investment we're talking about in some of these areas. So, hopefully that helps.

Analyst - *Deutsche Bank*

Do you think this investment will accelerate the top line growth of the overall company? Is it significant enough to move the needle? Or is this investment required to maintain.

Bob Wayman - *Hewlett-Packard - EVP, CFO*

This is a trap question. I'm not going to go there. Obviously you must -- you wouldn't make the investment if you think it wouldn't make a difference. You can of course debate whether it's just a difference to sustain the kind of growth you've achieved or to build on it, certainly there's some of each in what we're doing. We certainly hope to drive a little more growth. We don't think we're in industries that are going to lead us to double-digit growth rates. But certainly if we execute properly and we get our costs in line, it's our goal to over time get a little more growth.

Analyst - *Deutsche Bank*

You mentioned improving profitability in the servers in the PC business. Maybe you can elaborate on what's driving that improved margin -- the improved margins in both of those segments.

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Sure, let me make one general comment that will apply to all of tech mix. As I said a moment ago in our restructuring, a big piece of that is in the horizontals. The functions that support all of the businesses. So in every businesses case, there is some benefit to the cost structure by the actions that we have already taken. Again, the benefit changes the 6500 heads that are already out so, everybody benefits from that. In different proportions. And certainly PCs and industry-standard servers, lower proportions than some of the businesses that utilize more services. These are much more simpler businesses if you will that don't consume as much IT and as much as some of the other horizontal capabilities.

That's in all of our businesses, certainly in PCs and industry standard servers. In both those, as well, we've been focused very much on improvement in execution. There are a couple of examples that I will give you in that. We've been talking about this frankly for 18 months. We needed to improve our attach rate, the option mix, the display mix, the memory intensity, whatever it might be. We've had success in both industry standard servers and PCs in doing so. Both direct and through the channel. It's been very much a focus and that has improved the profitabilities. We have focused much more on our pricing discipline, our discounting discipline in both of these businesses.

You may recall, I hate to bring it up, but Q3 of '04, which was a very bad quarter for HP, particularly in the enterprise sub space, but even a little bit in the PC space it was clear that we had people making discount decisions without a complete understanding of the implication of those decisions. We have pulled back in some decision-making authority. This goes way back 18 months ago, but it takes a while to have these things play out. If you look at the trend in PC profitability in particular, it's been very steady quarter by quarter improvement and discipline around pricing is one of those things that has benefited. So, those are some examples of what we're doing. In both of those businesses, as well, the increased presence of AMD is a benefit.

Analyst - *Deutsche Bank*

Is there any way you can give us some color or quantify how the mix shift of AMD has impacted the profitability of the PC business?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

I won't say anything quantitative about linking those two at all. Clearly in consumer PCs, you can see it, you can go to the stores and see it yourself. AMD has a good market share in our consumer PCs. A small but increasing market share in our commercial PCs and I say PCs, to mean both desktops and notebooks. Industry standard servers where they're active and they've got some capabilities that the market wants. And the key takeaway for investors in Hewlett-Packard and maybe anyone else, but I will speak for me, having two competitors instead of a -- two competitors supplying you instead of dependence only on one is a good thing. I am not going to quantify how it's a good thing. I don't think I have to. You can just understand that it makes a difference to have two suppliers who are capable.

Analyst - *Deutsche Bank*

Intel's clearly lagging AMD in terms of price performance currently. And there's been a lot of talk that Intel has turned more aggressive on pricing CPUs here in the near-term and that perhaps in Q3 later this year, they will reach AMD's price performance. If that plays out and we see Intel start to regaining market share in the marketplace again, how does that impact the profitability of your PC business? In other words, if that mix shift switches the other way, can you continue to show that steady margin improvement you've been experiencing?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Well, a couple of points. First is price performance. Yes, AMD is ahead in some places, Intel is still ahead in some places. It's not a generalization that you can make. There's no doubt that Intel is focused on what they can do to get back ahead and AMD will then respond and whatever. I can't possibly play out for you how this comes to be. We're just going to have to see. It can be price performance. It can be availability. It can be all kinds of relationships that matter in this. Again, the takaway is -- that's really important is two is better than one when it comes to suppliers.

As it relates to PC profitability specifically, we have seen some nice gains, not only the last five, six quarters, but the last four years, coming out of a negative territory deposited. We've guided to 3 to 4% profitability. We're getting reasonably close to those ranges. I wouldn't extrapolate the rate of improvement that we've seen in the last year or two, out into the future. Even with favorable supplier dynamics.

Analyst - *Deutsche Bank*

I have to ask the inventory question in the channel. A lot of chatter about competitors having excess inventory in the channel. Some concerns about HPs levels of inventory. Could you comment on your own existing inventory levels and perhaps what you're seeing at competitors?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

So as of end of Q1, so, end of January, when we reported, we announced that our channel inventories were broadly in good shape. After a month of continuing to probe, it's clear that that was the case. Including in Europe, including in PCs, including in notebooks. We have no major slice of channel inventory by GBU or by significant geography where we have a problem. I won't say it's the best channel inventory we've ever had, but it's close to the best channel inventory we've ever had.

So clearly there are some problems in Europe. One of our competitors in Europe apparently ended February with too much channel inventory. That's a concern. It doesn't mean they're going to be trying to move it. And so it creates some pressure, but in our mind, it's more like business as usual. It's not -- got way more plays than from our perspective it should have. One of the other issues that contributed to it was come comments on us canceling some orders in the supply chain in Asia. Mark Hurd dealt with this at another conference recently. The point is we're adjusting our demand all the time and you're always going to find things where we said we thought we wanted that much, now we only want this much. We want some more over here. So there is nothing to report at this point.

Analyst - *Deutsche Bank*

You mentioned how inventory can sometimes create a competitive challenge. Have you seen a significant change in pricing in Europe?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

I'm not going to comment on anything since February 1.

Analyst - *Deutsche Bank*

The next logical follow-up would be the noise from Bell's been that they were going to turn incrementally more aggressive on pricing here in the near term. How does that impact your outlook for your PC business?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

We're sticking to the outlook. We haven't seen anything yet. Some of our competitors are masters at putting out messages and sometines they do it for marketing purposes just to make sure that the customer world believes that they're being aggressive. I don't know. If I looked at their particular set of financials and demands that they have, it's a different world between HP and Dell. Dell has competition that they didn't have for five years and we're getting our cost structures in excellent shape. You look at our supply chain, I will choose the best, but you look at our supply chain on consumer notebooks. Not only are we priced very aggressively, it is amongst the highest profit level within the PC group. So we are way stronger than we were before these two companies merged in the PC space. Way stronger. We will see what they do.

Analyst - *Deutsche Bank*

We're in a bit of a lull from a PC demand standpoint in front of a new operating system release from Vista? What do you expect from the operating system? Do you think this is a significant catylst? If so, when does it start to materialize? Do you have a view to overall PC unit growth this year and next year that's cooked into your assumptions for your '07 business model?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

I think Vista will be important. I think, it's been-- if you look back, it will matter. Usually these things build over several quarters in terms of affecting demand. But I don't think it's by itself it's a big enough effect to necessarily override other dynamics that could be going on. We've had a good PC market for a while here and some are calling for slowing. I think short of Vista, I could imagine that. But still good growth. We're still looking for very decent growth. We gave PC revenue growth for '07, back in our December meeting of 4 to 6%. We have no reason to update that at this point in time.

Analyst - *Deutsche Bank*

Okay. That's enough on PCs, I guess, for now. Maybe we will move on to jet printers. You're targeting mid-single revenue growth for the printer business in '07. How does that shake out in terms of unit growth versus supply growth? In other words what kind of growth--?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Well, you look at this last year and you see we've been growing units 8 to 10, 11% per quarter. That's good. These are generally good units. We hope we can sustain that. That's a challenge in this marketplace to continue growing it like that. But if you do that and these are good units, meaning one that drives ample supplies, you start to see supplies -- revenue growth acceleration and we've begun to see that. So our models would imply that we should continue to see that. This past quarter, I think, supplies revenue was up 11%, something like that. And if that's the case -- if the model works the way I just described, you will see supply revenue grow a bit faster than hardware revenue. And that would be a good thing.

Analyst - *Deutsche Bank*

You're tracking towards a high end of overall marin goals for that business, currently. In what's a pretty competitive pricing environment on the hardware side. Does that reflect -- A, does that reflect restructuring benefits coming through more significantly into that business unit than perhaps others? And secondly, how sustainable is a 15% operating margin?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

We're not even 15 yet. Now it's--.

Analyst - *Deutsche Bank*

14.9?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Okay, so, remember, IPG began restructuring before Mark Hurd got here. So they were doing a relook at their business. VJ ame to the conclusion in late '04 that it was time to take a fresh look at his resource allocations, cost structure, et cetera, et cetera. His profitability was dropping down into the 13 kind of range. So they took actions in I can't remember exactly, but let's call it March or April, so our Q2. So they got a head start on the cost structure. That means they will get less direct benefit going forward compared to some of the other businesses, but they will still get their share of the horizontal benefit that I described earlier. So they're going to see that happen.

We still have lots of competitors in the printer market. Some guys have been around a long time who are having their problems. Some that are doing very well right now. Some that are relatively new to the printer space. Samsung would be an example of that. They're very healthy, capable company who have announced that printer market share goals that are significant. So lots and lots of dynamics. You see a company like Lexmark or Epson, both of which has acknowledged issues. That's good. I think that means we're doing our job, but it also brings with it a required reaction on their part and we will just have to see what that reaction is and what it means.

We've been through all kinds of challenges in imaging and printing and I think, again the takeaway here is that we are big and we are strong. We've got technology, we've got market reach. We have fought off battles from almost everyone here and I think we're well-positioned to continue doing that. Whether that translates into 13 or 15, frankly, I don't want to say I don't care, obviously bigger is better. But for the long-term it doesn't matter if it's 13 or 15. What matters is that we maintain the strength that we're now exhibiting.

Analyst - *Deutsche Bank*

Have you seen a significant shift in the competitive environment in call it the past three months or so? And have you seen Lexmark start to pull away from that ultra low end business? If so is that something that HP is interested in?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

So, I -- we have seen little change at this point. I guess there's some evidence that they have backed off at the low end, but it takes a while before you really see these things appearing. We have always been a little cautious with the low-end business. Obviously at some price point, which if it's good it into the middle range business, it's good business, or could be. But HP has been preaching for a decade or so here that low-end users aren't -- the life cycle profit model doesn't work. Because they don't buy the supplies. So you really want to emphasize the guys that are going to buy the supplies. That's what we do all the time. It sounds like some of our competitors are now saying that's a good strategy, too. We will see what happens here.

Analyst - *Deutsche Bank*

All right. There's been a lot of talk about Kodak's new inkjet product expected in Q3 or so. What are your thoughts around Kodak's strategy? How do you factor this into your thinking over the back half of this year?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

It's -- we don't see it as anything particular in the last half of the year. Any time a competitor with intellectual property and a brand name comes to market, you have to pay attention. But as you know, others with brand names and technology have attacked the inkjet space, as well. Maybe they attacked it wrong, but they failed. It's not just technology and name -- if you want to get into this business, you've got to have the strength to put those units out there for three years at a loss, before you build up sufficient stream to turn this thing into a profit maker. The barriers of entry, not only from technology but from this are significant. I think Kodak's -- they're certainly a good company, but they've got their issues. They also -- you can imagine that they really need to do this. So we're watching it closely.

Analyst - *Deutsche Bank*

I'm going to open it up to the audience now. If there are any questions, I think there are a couple of mics out there in the field. In the meantime, I'm going to ask a services question. Seems to be a bit of a shift in strategic thinking around that business from growth to more margin enhancement. Can you walk us through the thinking around that strategy?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Yes, I don't know if I'd use the word change in strategy. Certainly there's a change in emphasis trade-offs between multiple goals, both of which are good. The strategy was, after the merger, to gain some scale in that business. We felt that was an important thing to do. We had the financial wherewithal to support that, but, again, even before Mark got here, we were doing scenarios of slowing down the growth while we got the profitability closer to where we wanted it to be. At the same time, understanding that you're operating in an environment where deals come up and you can't pass everything up. You've got to decide what you're going to take. So Mark has taken a more -- stronger line on let's get the costs right first. Let's get the profitability right before we begin to focus on reaccelerating the growth rate. We're in that stage at this point. Particularly on managed services that we're talking about, not services in general but managed services.

Analyst - *Deutsche Bank*

What's the existing utilization rate of your workforce in that business? And is that a good indicator to watch going forward in terms of future profitability?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

You need to think of this as our services business in three pieces. So were you talking about managed services or more broadly?

Analyst - *Deutsche Bank*

Maybe more broadly.

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Okay. Let me start with the biggest piece. The what we call technology solutions or the support business. Our utilization rate in the support business is quite close to where we want it to be. This is the folks that service all the products that we have service contracts on across the world. We are going to through adjustments in that business of reducing headcount in higher cost areas and moving whatever tasks we can to lower cost areas so that's one driver of profitability there. But overall utilization improvement, nothing material to expect there. In both consulting and integration and managed services, part of the profit improvement expectation is around some better utilization. We do not give out specific quantified goals for that.

Analyst - *Deutsche Bank*

If you're pulling back on growth in closing deals, how do you drive utilization? Is it more just taking out more capacity?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Yes, you can take out capacity, certainly a consolidation of data centers where you can do it, certainly some headcount reduction where it needs to be done, those kinds of things.

Analyst - *Deutsche Bank*

Do we have any questions?

Unidentified audience member - - *Analyst*

Hi, Bob. Can you talk a little bit about your storage business? I know the past couple of quarters you've lost a little bit of share now and it's been coming back. I think you have a refresh coming in the mid range product. Can you talk a little bit about what's going on with your business there?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

The dynamics of the storage business have been pretty extreme the last year or two. We really fell behind in -- certainly by '04, we realized that from a product offering point of view, we were not where we needed to be. We really had a significant rollover to new, stronger product offerings in all of the growth areas of that business. Do keep in mind that our storage business still includes a lot of tape, which is a -- the overall tape market is not a growth market. If you look at our growth this past quarter, in fact, tape was somewhat negative. So we still did quite well, double-digit kind of growth rates in the areas that we are emphasizing for the future. We feel very good about the product positioning for the most part, right now. That is we think we're in a normal to strong position.

But, of course, we're always investing in the next offing and we have some -- some expectations there for later in the year, but I won't be more specific about it at this point in time. Profitability in storage has improved nicely with the new products. Growth is still not where we want it to be. We are investing in additional sales resources. We have and we are continuing to invest in additional sales resources in this business. We want to drive a little more growth and a little better profitability, as well.

Analyst - *Deutsche Bank*

Any other questions from the audience? While we're on the enterprise, can you give us an update on the transition to Itanium? That's an announcement recently in that field, both from a business standpoint and a financial standpoint, how does that mix shift impact the profitability of that high-end server business?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

All right, I'm sure I will not go quite as far as you'd like me to here. But the move to Itanium is going strong. It represents about a third of our revenue from BCFs or business critical servers. The area of our portfolio that Itanium is being supplied. A third of the revenue is now from Itanium. The growth year-over-year, I don't remember the number, but it was very, very large. So it's moving very, very well. The number of ISVs that have ported to Itanium is growing rapidly. Some of the announcements you've heard from us and Intel, the last few weeks, talk about further funding to drive even more software capability on Itanium. So, it's moving well at this point in time.

Having said that, old operating systems and old microprocessor systems, they have long tales. They just -- they really do. I don't know how long it will take until it's 100% Itanium. Probably longer than you or I think. These things move slowly. We are no longer investing in TI risk, but we're still building TI risk and offering TI risk. We will do that until customers don't want to pay a sufficient price to support us doing that. And the business shift will occur accordingly. At some point we will encourage them to no longer buy and we'll see when that goes. Of course, I'm talking now about product.

The service tales on these things will go on decades, possibly. We certainly -- they have examples today of operating systems that were obsolete a decade ago that we're still supporting, so, we will see where it goes. Itanium profitability is quite lining PA risk profitability. It's just the makeup is different. Our OpEx ratio in DCS has been coming down significantly as we have stopped investing in PA risk. It's just been a large change over the last couple of years. So if you look, as I do, if you look at gross margin and OpEx ratios, the behavior is good and what you would expect given the fact that we are in effect outsourcing microprocessor development and production and development to Intel. So, it's okay.

Analyst - *Deutsche Bank*

So it's more or less a wash at the operating profit line?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

I'm not going to go quite that far. But it's okay.

Analyst - *Deutsche Bank*

The ISS business, you talked earlier, mentioned briefly about improving profitability in that segment. Can you come back to that and kind of revisit what's driving the better margin performance in the industry standard servers?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

It's what we call execution, focused on pricing, focus on attach rates, working with the channel to make sure that we motivate them, to sell a rich mix of our stuff, not just the low end of our stuff. It certainly, as well, as I said, AMD in the mix. It's an important contributor to margin improvement. And then OpEx ratio again coming down in that business.

Analyst - *Deutsche Bank*

It seems like in Q4, across the industry, industry standard server revenue growth decelerated a bit, is there anything behind that that you can see from a demand standpoint or an economic overall macro environment standpoint?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

No, nothing -- I can't really add any perspective on that. We've talked about it as well. I think at this point, whether it's a trend or something else, we will just have to wait and see. And it's not huge, but it's a little bit.

Analyst - *Deutsche Bank*

Kind of stepping back again away, we started off talking a lot about the restructuring program. Walk through a lot of good areas business units. One part that -- I'd like to get your perspective on where Mark is heading, three to five years out. Does he need to do a large acquisition? Or will he do a large acquisition to make a greater push in the software and services area? How is Mark really ultimately positioning this company for the long haul? Once we're past this restructuring thing?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

It's a bit too soon to tell. But I will give you some reflections on it. You saw our strategic statements at the December meeting in terms of the areas of marketplace where we think we're well positioned, et cetera. We have talked from an M&A point of view, about certainly software services, storage, even within "The hardware space." Blades, et cetera. These are areas where where we have and will continue to make acquisitions. We have decided -- we're getting this question a lot, of course, about acquisitions, we have decided to use the term digestible acquisitions. We're in the market for digestible acquisitions. Now, you can relate easily to that the types of acquisitions that we did in software over the past couple three years, but that's not to say that it has to be tiny to be digestible.

We're not in the market to do a transformational acquisition. Will Mark feel better about that after the restructuring or after we achieve the kind of profit goals for '07 that we put forth? I would suspect he'll take a fresh look at what's the right thing to do. We're strong financially. As we get the stock price up, we can even consider using stock to do acquisitions as opposed to just the cash that we have. We have a lot of cash, we're generating a lot of cash. So, -- and it's a consolidating industry, can't forget that. It has been and is consolidating. We absolutely believe it will continue to consolidate. So we will be acquisitive. But we don't really have an appetite for a really big operationally-challenging acquisition of a compact nature at this point in time.

Still more work to do in it the core business? Yes, and lots of opportunities to just execute better in the core business. So we want to do that first. One more question on use of cash. You obviously have a large cash balance. What's the thought of increasing the buyback, putting more leverage on maybe perhaps putting some leverage on the balance sheet along with your cost of capital, et cetera? So nothing to say on putting more leverage on the balance sheet.

Not that we don't address it periodically, but virtually all of the debt on the balance sheet today is for our financing company, which we want to use debt for that. This is still a very volatile industry that we operate in and we think leverage needs to be thought about very, very carefully and cautiously. So we're not saying we won't do it. We do talk about it. But at the moment we've decided not to. We've been aggressive on share buybacks, as you've seen. Starting 18 months ago, certainly all throughout '05, and then at the end of the year we announced this prepaid collar, is the term if I remember right, again, an indication of our commitment to share buybacks. As we go forward. And that, by the way, is alongside of a continuing open market purchase program that we have. We will decide time period by time period just exactly how much of that we do. Any questions from the audience? We have just about a minute left.

Analyst - *Deutsche Bank*

Okay, Bob, I will finish with an overall IT spending question. How is Q1 looking? How is the demand environment? Have you seen any material changes in spending? What's your view on kind of the macro environment for your business?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

You saw RT1, which ended in January, -- it looks okay. I think it looks at least as good as it has for, what, four years? Something like that? And in our discussion, my discussion with CIOs and CFOs, it's my impression that after three, four years where generally there's been very tight reins on IT spending that people are being a little more open-minded to investments, so, I wouldn't say I'm optimistic, but I think that things are lining a little better than, '03, '04, for sure.

Analyst - *Deutsche Bank*

Any specific area of relative strength or weakness if any?

Bob Wayman - *Hewlett-Packard - EVP, CFO*

No, I'm really just talking mindset, budget sorts of things, not categories.

Analyst - *Deutsche Bank*

Great, if there are no more questions from the audience, I think we will wrap it up here. Thanks, everyone.

Bob Wayman - *Hewlett-Packard - EVP, CFO*

Thanks for having me. [Applause]
