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HPQ - Hewlett-Packard Securities Analyst Meeting with Senior Executive Management

Event Date/Time: Dec. 13. 2005 / 8:00AM ET

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P R E S E N T A T I O N

Unidentified Company Representative

Ladies and gentlemen, please welcome Vice President, Investor Relations, Brian Humphries.

Brian Humphries *- Hewlett-Packard - VP, IR*

Good morning, everybody. Thanks for attending today's events and our annual securities analyst meeting, and we're pleased to see a full house. It's been quite a year of change at HP, needless to say. We're excited to be here today to give you an update on our operating growth and efficiencies framework and during the course of the day we're also going to bring you through our FY '07 financial targets. We've got a full schedule today. We tried to make the format as interactive as possible, and we structured the morning around a series of presentations, followed by Q&A sessions.

Mark Hurd will kick off the meeting, followed by Bob Wayman. We'll then have a Q&A session for approximately for 40 to 45 minutes. Ann Livermore will then review TSG, and Steve Smith will then give a deep dive on HP Services. Todd Bradley will then present Personal Systems Group, followed by VJ, who will present the imaging printing group. We'll then go into an executive Q&A session, again, lasting approximately 45 minutes for the four presenters.

During the Q&A session, I'd ask that you refrain from asking your question until a microphone is passed to you. We'll try to stay as closely aligned to the agenda timeframes as possible. The event will formally end at 12:30. However, for those of you joining in person today, we do have an investor luncheon thereafter. I'll ask that you just follow through the doors here on my left, on your right, to the adjacent room, where you'll have the opportunity to further mingle and interact with management and ask any additional questions you may have.

I want to just finally add that HP has provided a wireless network for your use. The specifics in relation to connecting to the Internet and hotspots are listed in your pack. Finally, this event is being Webcast, and an archive will be available for approximately one year. I'll leave my introductory comments with that, and I'll now ask Mark Hurd to join me onstage. Thank you.

Mark Hurd *- Hewlett-Packard - President and CEO*

Okay, good morning. Thanks to everybody for coming. I thank Brian for inviting me. What I'm going to do for the next 45 minutes or so is try to cover a few basic points. I'm going to talk a little bit about my first impressions of Hewlett-Packard. I get questions all the time about how I felt about the company since I've joined, what was I surprised by, anything I was disappointed by, and I'm going to share some of those thoughts with you. Talk a little bit about the operating model that we're trying to build, focus on opportunities for us to do a better job on the cost side of the equation.

I'm going to talk to you about how I think about cost and how we'll apply that to the company, give you an example, a specific example in the company of how we're dealing with that. We're going to talk about some market trends, trends that we think

are important in the IT sector and things that we'll try to do to take advantage of those trends that we think play into HP's strength to grow the company, talk a little bit about our go-to-market model and close.

Bob will then come up and talk to you about the numbers, and then Bob and I will do a joint Q&A, as Brian referenced. So that's what we'll try to do over the next 45 minutes, so let me start with a chart that may be a little bit tough for you to read. I know you've got copies of it in your book. But this is really what I saw in call it roughly the first 60 days that I was with HP, and probably, like many of you, I had consumed a lot of information that was available to me in the public before I came. When I joined, I got the opportunity to talk to a lot of people in a relatively short period of time, and here's kind of what I found.

I would tell you that not everything was good, nor was everything bad, and so in the end I would say it was kind of a mixed report card, and let me take you through it a bit. First, investors, many of which who are represented here today, clearly confronted with the results of the company have been inconsistent. The stock has certainly been volatile, to some degree disappointing, as a result of that inconsistency. And while the portfolio of the company seemed compelling to some, its value hadn't been proven, and I'll throw in my own view, and clearly that of many investors.

Even when you looked at the current period financial performance of the company, the company was undervalued, with a very challenged multiple. During that same timeframe, as I was getting input from investors, I got the opportunity to see in a really short timeframe about 400 customers, and I quite counting, frankly, after about 400, and I got the opportunity to cheat (ph) and got to see some customers in group settings. And I got fairly consistent input, and I would say the following things.

A lot of innovative technology in this company, technology that people feel very comfortable with, and they really feel is on the cutting edge. Certainly for somebody outside the company, it's amazing, the strength of the HP brand, the loyalty it brings from customers and the support that it brings from customers, a strong desire on the part of customers to see HP win. So a lot of support for the brand, desire to see the company win, strong technology base. At the same time, viewed as a company that's really tough to do business with, tough to engage with, once you do, hard to find out who's really responsible for applying resource, for engaging that resource, who can make a decision. And the sales and go-to-market model, along with that accountability, was complicated.

Speed of getting to a decision, slower than what they would recognize from competition. So, again, it's not all bad, some assets to build from, but clearly opportunities for us to do better. And I would tell you, on the employee side of HP, I frankly came in expecting to find a company filled with employees that were demotivated. I had read much of the stuff in the press, many things written by people from Wall Street, and while I found morale to be mixed, I found something that I didn't expect, and that was a company filled up with people that really wanted to go improve the company, people that were ready to go fight, people that wanted to change the perception of the company and people that wanted to go win.

So I wouldn't tell you that there wasn't an effect based on what transpired. There clearly was. The people in the company are clearly susceptible to reading the same things that you all have seen, but, again, a strong desire to change and improve it. Operationally, I'll give you my observations. A very complicated organization model. The same thing you heard from the customers is what I witnessed in the company. I talked before, I'll say it to you here today, that when you're running a business here at HP circa April 1, if you ran one of the divisions, you typically had in the neighborhood of 30% of the cost and expense in your P&L directly under your control, and that's too low.

And when you translate that to an organization of our scale, and you drive that down deep toward the customer, it's what causes those decisions to be made as slowly as they get made, so highly matrixed, fractured organization model. In spite of popular belief I heard coming into HP that the company didn't have information. It didn't understand what was happening to it, it frankly was short on analytics. I would tell you that's not what I found at all.

I found the company deep in data, deep in information. They had done a lot of work. It just hadn't been executed. So when I showed up, in spite of popular belief, with announcements we made in July, they didn't start the day Mark Hurd showed up.

The work had been done in advance. The analytics, in my opinion, were good. We just needed to execute. We had some work to do, but I would call it a small piece of the overall work that just frankly needed to be operationalized.

As much technology as I expected to find in the company, and I expected to find a lot, I found more, and I would tell you that I don't think we're as good at making all of that - as innovative as the customers think we are, I don't think we're as transparent nearly as well as we could be to those customers about how much technology really fits in the company. So, again, I'd say a pleasant surprise, and certainly the advantage of the scale of a company clearly was there.

From a financial perspective, in spite of sometimes what I read, this company has been able to grow. This year in '05, as you've seen with our last numbers, the revenue growth was in excess of $6 billion. That trend had clearly been there for a while. At the same time, that growth was coming from lower gross margin products, which in the end was causing gross margin erosion, even with that scale. And, clearly, all of you that read income statements, and I read a bunch of them, we had a spending rate that didn't align with either the growth or the gross margin erosion that was coming with that growth, so we had looseness in our spending profile, and at the same time, had I'd argue one of the best balance sheets, not only in the tech sector, but, frankly, around the Fortune 500.

Now, net-net, I've taken you down a lot of different paths here. This is 60 days into HP, and I would tell you again, in spite of popular belief, not everything I found at HP was bad. Not everything I found was perfect, but I would summarize it to tell you, a lot of technology, strong desire on the part of the people to win, complex, lot of matrices, low on accountability, strong from the balance sheet perspective, cash flow from operations, and a little bit loose in our spending, with a customer base that badly wants to see us win and come out and compete.

So, let me tell you a little bit about the operating framework that we want to drive, and I do get questions all the time about what do you want to drive? Do you want to drive growth? Do you want to focus on cost? And I try to tell everybody in the company that I can't work in a singular-oriented model. We need to work on all three of these levers at the same time, so as you're going to hear us talk, for example, our capital structure, we'll actually leverage our capital structure to do two things. We'll actually spend money so that we can save money. We'll actually leverage our capital structure to fuel growth. We'll work on lowering our expenses to improve not only our financial performance, but to improve our capital position, and we'll clearly grow so that we can also leverage our capital position, to lower our cost structure at the same time, I believe, the faster we can grow.

So, all of these things are interrelated at their core. We want to be as efficient as we can be and align our capital to the best opportunities and the optimal opportunities that we see in the market that can allow us to go scale the company. Now, I'm going to talk to you first a little bit about efficiency, cost, tell you a little bit about how we think about it, and then give you an example, and then we'll talk a little bit about growth.

So, first, let me tell you a little bit - this is a bit of a busy chart, but there are clear messages that I want you to understand about the way that we think about a cost framework. First, we went about the process in early April to benchmark the company, and don't get me wrong about benchmarks. Since I've been at HP, I hear a lot of people talking about - benchmarking is just gathering data. It is not, by definition, the answer. It is a piece of information. It is a piece of information you can ground on.

Now, I believe benchmarks occur two ways, tops down and bottoms up, and we're working on those processes simultaneously. They come from the bottom up, they come from the top down, and by the way, when you benchmark, you can't gather data that's current period, because when you do, it's 2004 data, and by definition if you move to that place, you will always be behind. You want to move to where the puck is going, not to where it's been. And you want to talk about how you can lead in those areas as opposed to follow. So, by definition, a benchmark is interesting, but it's not by definition fascinating. It is a piece of data, forward-looking, tops down, bottoms up.

Then, once you establish those goals, you have to have clear ownership of those objectives. We can't require the need to have a biochemist in a room to bring multiple parties together, to go take ownership and have clear accountability for those objectives.

We have to have a structured process, and, obviously, we want to measure and have performance reviews around attaining those objectives. Importantly, though, if you just have cost objectives and you can't align those with the capabilities you want out of the function, you will not win.

So, in the end, the cost objectives that you target have to be aligned to the capability you want out of the function to achieve the goals and the targets you have for the company. So it becomes complicated work. It's not as easy as just saying, hey, this cost a dollar, why don't we make it $0.80? Because if we make it $0.80 and we can't gain the capability of what we want in the function, the rest of the company may fall apart, so you have to align the capability you want in the function at the same time as you align to the cost.

And I would tell you, you may have heard the comments about the curse of the blend company. In a blend company, you have very interesting phenomena that occurs. A blend company would be defined as a company that has multiple business models underneath its tent. We happen to have a broad range of business models. We have a software business model that behaves extremely - it is unique to the PC model. Different gross margins, different OpEx structures, and when you align a cost structure, particularly a horizontal, shared-services cost model, that model most times gravitates to the most productive business model under the tent.

That is typically the curse of the blend operating model. Flip that around, the real objective is to build your cost structure so that it best aligns to your most competitive businesses, so that in the end the other businesses gain competitive advantage as opposed to competitive disadvantage. And it won't work to create a peanut butter spread answer for the company.

It needs to be aligned by business model so that each business has the opportunity to both compete at the appropriate cost structure and at the appropriate capability level. That's caused us to have two things occur. One, we had a catch-up action which we announced July 19th. Think of this as a one-time action to get the company where we wanted it to get, at the same time as we're not stopping fundamentally there, but instituting a process that is a continual process for us to zero base budget, to question all of our costs, to look for opportunities to realign that cost and to ensure we have accountability for that process at the same time.

Let me give you an example in IT. IT is - I'm not going to give you all of the details that sit on this chart, but if there's three takeaways I could give you from HP IT, three objectives, one, we have a complicated architecture, a lot of data centers, a lot of data marts. We have an opportunity to simplify that and take cost out, point one. Point two, we have the opportunity in IT to build the capability in terms of delivering better information to the company, that will help us better understand our markets, better understand our customers and help us grow.

Thirdly, the opportunity to be the best implementation of the next generation of technologies, the best of enterprise, next generation data centers, in the industry. Three objectives - get costs down, deliver a capability to the company that is better than today that allows us to use it as a platform to grow and scale and to manifest itself as the best user of HP technology with where the market's headed over the next five to 10 years.

And all of the stuff that you see on the chart are examples of where we've been, to what we're moving to, that will bring cost out. You can see us mention our enterprise data warehouse. We have our data. We love our technology. We have a lot of it, and we have our data in some 700 different spots, and we have the opportunity to eliminate those and create one enterprise view of our data, we will do that, and that will be a major help to us in better understanding our markets and our customers.

So, what I tried to do was tell you a little bit about the way we think about cost, to give you an example of that being manifested in IT. We are questioning everything, zero-based budgeting, simplify our architecture, make everything as easy as possible. At the same time, though, we have to deliver the capability that I described so that we can support the growth strategies of the company, at the same time, as an example of our technology.

So I am going to move away from cost and away from IT and talk a little bit about growth and talk a little bit about what we want to accomplish, and that starts with establishing Hewlett-Packard as the world's leading information technology company, and with that, I'm going to talk a little bit about some market trends that we see that we think are occurring over the next several years that we want to take advantage of. And I'm going to spend a few minutes on each one of these, but at a high level, they revolve around the change in enterprise architectures. This is the movement away from monolithic mainframes, the move to distributed computing and the way that's all going to evolve over the next period of years.

Secondly, the continued evolution of call it mobile computing, continuous computing, what's going to happen in that marketplace over the course of the next five to 10 years, and then, thirdly, you're going to hear us talk a lot about the ubiquitous digital printing market, and we're going to talk not a lot about printers, we're going to talk about printing and what's happening in that printing market and how that market's going to evolve and grow.

Think of these as three market movements that we think we're positioned to go capture, and I'm going to go into each one in a little bit more detail and then let Todd, VJ and Ann talk a bit about it. Before I do, I want to give you kind of the same framework I did around cost, around growth. There are six ways - let me start with six ways I know of to grow a business. One, starting with leveraging your core portfolio, if you leverage the portfolio capabilities that you have today, and those start with don't invent anything new, just transform the market. Take existing products you have today, just change the market.

Secondly, which most people, just do a better job with the portfolio you've got. Fix your costs, improve the competitiveness of your products, leverage that portfolio and exploit it, probably the most traditional used growth strategy. Thirdly, take the markets you're in today and just consolidate them. Use your balance sheet, roll them up, take the market leadership position.

Secondly, bottom part of the chart, you can move into new markets, adjacent markets, markets that are related to your core, but not directly, and the ways to do that. You can invent a brand-new product, breakthrough innovation. A little bit yesterday we talked about halo collaboration. I could give you examples of breakthrough innovation that just changed the game.

Secondly, you can organically, using your existing R&D, invent a new thing, invent a new product, or, thirdly, go out to the marketplace and buy something that you don't do today. Six different ways to grow a business.

Now, let me talk a little bit about some of the market trends that we see. First, you're going to hear us talk about the next-generation data center architecture. You're going to hear Ann talk about it. It's advancing the adaptive enterprise, which you've heard HP talk about for quite some time. And there are some very important trends that are going to occur over the next several years, and that's the fact that you're going to continue to see the cost of computing decline.

You're going to continue to see a movement to standards, a movement away from mainframes, the virtualization of that processing capacity, meaning I want raw processing capacity available to me that I can dial up or dial down, depending on my requirements, the same virtualization of that storage capacity. And I'm going to want to be able to have that capacity anyplace I'd like to have it on the planet Earth, and it's likely that instead of having a lot of humans running it, I want to have a 7/24 lights-out computing environment that's frankly run, monitored, controlled, remotely.

And that means all of that leveraged industry-standard computing, the movement to Blade, the moving to virtualized storage, is going to have to be managed, and it's going to have to be controlled. It's going to have to be reliable and it's going to have to be secure. It's going to have to be integrated with management software. And, you're going to want to be able to, A, buy those tools and do it yourself. B, have someone come in and define that architecture for you, and then give you the tools. Or, C, just outsource the entire function, have someone come in and do the first two pieces and actually run and manage the entire environment for you.

Ann's going to talk more about that when she gets up, but this trend, I'm here to tell you, isn't going to slow down. It's going to keep gaining momentum, and I truly believe at the end of the day, arbitraging labor, you're going to hear us talk about our services strategy this morning, in the end, while it's an advantage, the long-run opportunity is to eliminate the requirement for

that labor, and the way you do that is by automating those processes. And that is a significant opportunity for us to align our software business, our services business and our ESS business.

At the same time as we manifest that opportunity in HP IT, leveraging capabilities from HP Labs, a market trend that won't slow down, but I think we're very well positioned to capitalize on. You're going to hear Todd talk a little bit about always-ready, always-on mobile computing. Think of this as the requirements for all of us to be mobile aren't going to slow down, either. Workplace is going to get continuingly more mobile. You're going to see a change in the way - I don't know how many people here are e-mail people and how many people here are voicemail people, and yet those markets are going to converge.

I believe you'll have the opportunity to take your e-mail via voicemail, deliver your voicemail via e-mail, and you'll be able to do it from wherever it is you want to do it, in a highly secure environment with personalized services. The ability for that office, that mobile office, to know where you are at any time, and to deliver personalized services to you no matter where you are. Again, highly secure, able to use whatever content you want to distribute to that network, again, leveraging the data center of the future that we described. And we don't believe these requirements are going to slow down. We believe they're actually going to continue to accelerate.

I talked a little before about the printer market and asked you to think about this as the printing market. I think it's an important distinction for us. Frankly, I think when most people think of HP and VJ is going to talk to you a lot about this later, they think of us as a consumer printer company, and that's very different than what I found since I've been with HP. Frankly, this market stretches from the consumer to small and medium business, the enterprise, the graphics market, and plays in many different spaces. Most people are familiar with the digital photography market, but frankly the market is even broader than that. The MFP market, the multifunction printer market, is really the morphing of the copier market and the printer market and much harder to come from the copier market to the printer market than the other way around. And the movement to MFPs is accelerating, and we think that's going to continue.

The opportunity for companies to now do their own market collateral. You're going to hear VJ talk a lot about the high-end printing market. You've seen us make a couple of acquisitions in that part of the market. We made the Indigo acquisition a while ago, with the Scitex acquisition we just made, all aimed at the industrial printing market that is today mostly analog, moving to digital. And we think we've got a significant play in that commercial marketplace, and all of those markets bring with them a strong annuity aftermarket to support them as well.

So, let me try to segue a bit from those three big market trends to talk a little bit about something that came up earlier that really came back from the customers, and that was our go-to-market model. I gave you some of the feedback that we got from customers about how we try to improve on that, and the thing about it I'd try to give you, we think their market trends that I just described are pretty strong. We think when you align our assets and our opportunities against those trends, we think we're well positioned. At the same time, we need to manifest those opportunities in terms of our ability to create demand in the marketplace, and that means for us the ability to scale at the same time having a go-to-market model that will give us reach and give us the ability to succeed.

And it starts with us creating the industry's best go-to-market model, and we're really trying to set as an objective to be no short of the best in dealing with how we go to market, and there are several key pieces to it. It starts with building the best sales force in the industry, and building the sales force follows some very simple principles. They're simple to say, a little bit harder to do, and that is to get your market, your sales organization, fully deployed, get them to all of the appropriate buying points. And you want to get them to all those appropriate buying points at the lowest possible unit cost possible. But you have to do it at the same time as you keep in mind that capability model that I described earlier.

It's no good getting fully deployed at a very low cost with people that when they get there can't get anything done. So you have to intersect fully deployed, lowest possible cost, at a capability level that can execute in the marketplace and win.

Secondly, we have to take advantage - in 2005, for example, we shipped over 50 million printers, over 30 million PCs, over 30 million industry standard servers. I could go on. Let me summarize, all that's a lot of stuff, and it stays installed for more than 12 months, and when you add all that together, combined with our brand, that is an incredible installed base. Where I come from, it's mind boggling. The opportunity for us to leverage that installed base is huge, one of the reasons why we think the opportunity for us to capitalize on customer data is central to our ability to create a great go-to-market model. We additionally - I get questions all the time whether we're direct or indirect, and let me try to address that today.

I don't even know exactly what that means, because we're not direct or indirect. We have some partners who are simply great, and we want to leverage those partners, partners that give us extended reach, partners that can bring products that we don't have that complement our solutions, partners that have a geographic reach that we don't have, an industry specialization that we don't have and bring a capability that adds value in the marketplace.

Not to be negative, but for a minute, we actually have some partners that don't always do exactly what we like. We'd actually like to have more of the former and less of the latter, and partners, the right kind of partners, are an important part of our go-to-market model mix. In addition, once you get all this deployed, we have to have a sales organization that is trained with tools so they can get quotes to customers as fast as anyone on the planet earth, they can get configurations to customers as fast as anybody on the planet, and they can be responsive to the customer as fast as anyone.

This is an opportunity for us to improve, and inherent in this is for us to push more accountability and more responsibility down deeper into our sales organization, and like all sales organizations, we'll have a batting average, and if we have bad ones, we'll get different people. But at the same time, we have to remove the matrix, get those people with the ability to make decisions, accountability and responsibility as close to the customer as possible, and take every piece of complexity that we possibly can off these people's backs and allow them to optimize their selling time.

The quickest way to increase your sales force, when I talked about full deployment, is to increase their selling time. You can measure how much time a salesperson spends in front of a customer. There's two kinds of good selling time, preparing to see the customer and seeing the customer. Most of everything else is not good. You want to lower the not good and turn it - I'm not going to give you our numbers today. I'm sure everybody would like the number. We get an outlook call every Friday on how we're doing. But, in the end, we can get more feet on the street by simply increasing their selling time and taking more work off their back.

So, important for us to not only capitalize on these trends I described, but if we really want to optimize our opportunity to grow, we have to get this part of the equation right as well. Okay, let me try to end a bit on why I see strength at HP.

One, these market trends that I tell you are going to happen with or without HP, and I believe they do play to our strengths. I believe the movement to distributed computing, the requirements to have heterogeneous integrated management software, the ability to virtualize process (ph) and storage, the movement to next generation data centers, the evolution of the adaptive enterprise. I think it plays directly to Hewlett-Packard's strength. I think, without a lot of fanfare, IPG has also repositioned itself to take advantage of the broader printing market as opposed to just the consumer printer market. And, long story short, I think these trends play to our strengths.

We'll drive on growth strategies, the ability for us to leverage our core portfolio. There are some new and adjacent opportunities you're going to hear about, and I think we're positioned to take advantage of those, and we will align our capital around those growth plans. We will execute on our cost structure initiatives. That is one of the ways that we have an opportunity for us to fuel our growth.

And I do believe we have strong assets. The technology in the company I believe to be second to none. The brand, the people, and these people, I believe, want to win, and it's our job as management to make sure we put them in a position to. And, probably most importantly, that we will build the culture of owning and being accountable for what we do. We will do everything possible

to execute on what we say, both internally and externally. Now, I won't promise to you you'll always like what we say, but when we do say we're going to do something, we will expend every ounce of effort to make sure that we live up to that commitment.

So, before we go any further, what I'd like to do is bring Bob up, and have Bob, since I've given you no numbers - Bob is going to take you through many. So, with that, here's Bob Wayman.

Bob Wayman - *Hewlett-Packard - CFO*

Thank you, Mark. Good morning, everyone. I'm going to cover a variety of topics this morning, starting with a quick review of '05 results. I will cover some multiyear trends in revenue and operating profit by region and by business segment. A couple of items on '06 guidance before moving onto some preliminary thoughts on an '07 operating model, where I will talk not only about company-level metrics but some segments metrics as well.

Next, the balance sheet and the cash flow, cover all of the key items there, not only in terms of what we have done to date, but some thoughts on how you should model those items going forward, and then a few comments on capital allocation. So here's a look at '05, revenue of 86.7 billion, 8% growth on a reported basis, 6% on a constant currency basis.

Gross margin at 23.4%, down a half a point year over year. We actually saw improved gross margin in the TSG, ESS, software and financial services, but this was more than offset by declines in IPG and services. Operating expenses, up 4% on a reported basis, so a nice four-point spread to the revenue growth. OpEx was pushed up by currency as well, and it did include the accrual for much larger incentive pay in '05 than in '04.

This resulted in an 11% growth in operating profit to a 6.4% operating margin. We have (ph) earnings up 16%. We saw the benefit of a lower tax rate, as well as improved other income, and then finally, EPS was a $1.62, up 22%, benefiting from a 5% lower share count on average, year to year.

Here's a multiyear chart looking at, on the left, revenue trends, and on the right, EPS. The bars in each case show the level of achievement that particular year, and they are referenced to the left-hand scale. The line chart represents growth rate, and that is referenced to the right-hand scale. So it followed revenue growth, not only in '05, but in '04 as well, and we actually had a little bigger help from currency in '04 than we did from '05. EPS, 22% growth this past year, following 15% growth in '04.

Here you see some regional trends, and the basic takeaway here is we've achieved strong and pretty balanced growth around the world. The Americas this past year was up 6%, a little bit of a growth rate improvement from the prior couple of years. Within EMEA, a 10% growth, following 15% in '04, and Europe of course saw a big help from currency in '04, just a four-point help in '05, so 10% reported, 6% constant currency growth for Europe.

Asia-Pacific, about 13% growth each of the last two years, in '05, 13%, as reported, 10% constant currency. Here we see some segments revenue trends, and again, pretty balanced strength across all six of the segments. In four of the segments, we actually saw growth in excess of 10%, software at 16, financial services at 12, ESS and financial services at 11% growth, TSG a nice 9% growth and IPG, 4% revenue growth for the year.

Here are the segment operating profit trends. The only difference in this chart is the line chart now represents operating margin. It was not a growth rate line, but a margin line. And what's really important here is that all four of our underperforming segments made substantial improvement in profitability over the past several years. Therefore, we now have a much better balanced portfolio of profit by business. Let me start in the upper left. TSG, moving from a loss position to a 2.5% margin in '05, greater than a $1 billion turnaround.

IPG achieved 13.6% margin for the year, albeit down from the lofty 16% levels of the prior several years. ESS, again, a huge turnaround from a loss in '02 to a 4.9% operating margin in '05, again, in excess of a $1 billion turnaround in profitability. Services

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profitability has declined, 7.4% achieved in '05, impacted by the competitive pressures in this business, as well as, again, a disproportionate share of the bonuses showing up in services.

Software, a $300 million improvement in profitability, albeit still to the full year a loss, but a much smaller loss in software, and, as you know, achieved profitability in Q4. And, finally, lower right-hand corner, HP Financial Services, another $300 million turnaround, achieving a 10% operating margin. So, again, key takeaway here is much better balance in profitability.

Next, just an update on recurring revenues, some statistics I give you at each of these meetings. Not much news here. Overall, recurring revenue in total has remained at roughly one-third of the total revenue of the company. Supplies on HP Financial Services pretty much going sideways, support and managed services showing a slight uptick in proportion of total revenue.

Before moving onto '07, just remind you of what the outlook was for full-year '06. We're calling for 89.5 to 91 billion in revenue, 3 to 5% reported growth, and I'll comment on that in the next chart a little further. EPS, pre-stock-based compensation, $1.88 to $1.95, and on a post-stock-based compensation basis, $1.75 to $1.82. Just a little more background on revenue growth. I want to make sure people do understand what our guidance represents. I think it's useful to look at it both on an as-reported basis, as well as a constant currency basis.

So, first the red line represents as reported, and you can see the relatively strong numbers that we've achieved there, 9% in '04, 8% in '05. So I think it's more interesting to look at it on a constant currency basis, going from actually a decline in revenue on a constant currency basis, moving up to 3% and then up to 6% in '05. And our guidance on a reported basis is of course the three to five, but we are now facing a currency headwind. After having been helped by currency the last couple of years, we have a headwind of a couple of points, and so it translates into constant currency growth of about 5 to 7%.

Just to update, reminder on what we've said about restructuring. We announced the restructuring program in July, we updated the headcount number to be 15,300 at our last earnings call. About 4,700 employees have left the company in Q4 '05, including 3,200 as part of the U.S. early retirement program. We also announced at that point some changes in our U.S. pension plan.

So the total estimated restructuring cost is 1.6 billion, of which 1.565 was recorded in Q4 '05. Total gross savings expected of 2.05 billion in '07, half of which we are modeling to fall through to operating profit. And, for your models, approximately 40% of the savings are in cost of sales and 60% are expected in operating expenses. So this next chart you do not have. It will be handed out in the room after my presentation here, and it will be available on the Web in a timely manner here.

First, the upper part of the chart represents segment information. The first column shows the range of revenue growth that we expect in '07. The column to the right is the operating margin we expect, the range of operating margin we expect in '07. So, starting first with revenue, let me say that what you see here is on a constant currency basis - who knows what the currencies will be doing by the time we get to '07, and it includes largely organic growth.

Basically, we are assuming the kinds of acquisition levels that you have seen from the company in the last couple of years, which have had minimal impact on short-term growth rates, and I'll comment more on that in a moment. So, TSG, IPG, ESS and HP Services, we're calling for growth in the 4 to 6% range in '07, software at 10 to 15, and financial services at three to five. This translates for the total company to 4 to 6% revenue growth range in '07.

TSG operating margin, 3 to 4%. IPG, no change at 13 to 15, ESS at six to eight, HP Services eight to 10, software, at 10 to 15, and HP Financial Services at six to eight. Now, we don't expect all of these segments to be operating at either the low end of the range or the high end of the range in any period of time, and specifically '07, and we are certainly expecting to manage the total company portfolio to achieve profitability in the range of 7.5 to 8%.

I should point out that we are not bringing stock-based comp effects to the segments, but the total company number you see here does include stock-based compensation. Beyond operating margin, we're expecting other income and expense of 300 to

$400 million for the year, a tax rate at 20%, and shares outstanding at around 2.9 billion, and I'll comment on some of these variables in more detail next.

Here's a chart showing our non-GAAP tax rates over the past several years, as well as the forecasted rates. We are forecasting a rate of 20% in both '06 and '07. Do note that we did better than that in '04 and '05, and while 20% is our best estimate of our underlying or structural tax rate, you should expect some volatility on this not only on an annual basis but on a quarterly basis as well going forward.

This is a chart that looks at the history and the forecast of our stock-based compensation. It has been trending down. Expense got from $0.23 to $0.19, and we're now expecting about a $0.13 impact in '06, and somewhere in the $0.12 to $0.14 range in '07. The impacts here include that of stock options, our share ownership plan, as well as the amortization of restricted stock. And do note that under prior accounting literature, there was a small expense for stock compensation in '04 and '05.

Okay, here's a pretty complex chart. I'm going to spend a minute or two on this. I want to look at share count. We continue to get lots of questions as to what is driving our share count, and while I will not give you a forecast on our share count, it just depends on a lot of variables, not all of which are in control. Hopefully, I can convey a better understanding of the key drivers here.

The upper portion of the chart represents actual shares outstanding, starting in '03, 3 billion and 44 million shares. During that year, we purchased 40 million shares and issued 39. Going onto '04, the share repurchases increased considerably to 172 million shares as a result of our accelerated purchase program in Q4 of last year, and purchases in '05, 150 million shares repurchased.

You see as well share issuance began to go up in '05, and this is a result of the increased share price and increased option exercise activity. So actual or basic share count declined 7% over this period of time. But what counts in the EPS calculation, of course, is the fully diluted share count, and that's what's shown now at the bottom of the chart. It starts with, again, using '03, 3 billion and 47 million average basic shares outstanding in '03. To that we have to add common stock equivalents, which represents a converted value of the in-the-money options. And this figure is influenced not only by the number of in-the-money options, but the degree of in-the-moneyness, so as the stock price goes up, this number goes up.

You see at the very bottom of the chart, in '03, the number of in-the-money options at that point of time, so 152 million shares in the money at that point. As you look to the right, you see the basic share count declining as a result of what you saw in the upper portion of this chart. You see the common stock equivalents growing to 23 million shares in '04, and then to 30 million in '05, but most importantly, look at the little blow-up to the right. CSEs (ph) have gone from 20 million shares in Q1 up to 58 million as we exited Q4, so this is working against our share count as we try to offset it with repurchase.

So, if you look at the fully diluted share count, actually down only 5% during this period of time. And, finally, just note that the in-the-money options have about doubled over those couple of years. And while not shown here, I just will point out to you, we do have a large number of options with strike prices in the upper 20s and lower 30s, so as we are operating in these price ranges, you see this leverage the CSE calculation quite a bit.

So let's transition to cash flow and balance sheet. This chart shows cash flow from operations, as well as free cash flow over the last several years - '05 was an excellent year for cash generation. We saw $8 billion in cash flow from operations and 6.6 billion in free cash flow, a significant improvement from the '04 levels, driven by very good working capital results, and I'll comment more on that in a moment. Obviously, helped by improved cut (ph) generation. Restructuring payments were low in '05, and retirement plan funding, which I'll have a chart on in a moment, which was actually very high in '05.

So let's start with working capital. Really excellent operational results across the board driving improved working capital. Starting with the blue line at the bottom, inventory dropped from 39 days to 35 days, albeit from a slightly elevated level as we exited '04, '04 to remind you was high due to ESS inventory we were still working out of our Q3 difficulties of backlog build, inventory

build, and ultimately revenue build. And, IPG, based upon their product introductions scheduled last year had a particularly high level of inventory as well.

But, nonetheless, 35 days is a very good outcome, down from the two-year-ago level of 37 days. Receivables at 39 days, down from 43. A year ago, again, a somewhat elevated level due to our ESS problems, as well as the European currency, or currency in general, pushing receivables up, and some acquisitions that we did late in the year that pushed receivables up. So nice progress on receivables as well, and, finally, payables up to 52 days from 51 a year ago.

A couple of other key items that impacted cash flow. Pension and other post-retirement benefits, that is, the funding of pension and post-retirement benefits, and cash used for restructuring. Pension is showed on the left. You can see we had pension funding of 1.7, almost 1.8 billion in '05. This represented somewhat of a catch-up or a carryover from '04, which was a bit unusually low, but also included the funding of our U.S. retirement program as significant funding went out in Q4 as people participated in the voluntary retirement program.

Importantly, looking forward into '06 and beyond, we expect much lower cash use for funding of our pension programs, and you can see the number here for '06 is currently predicted to be 365 million. So huge dynamics around pension funding.

Cash flow for restructuring purposes, you can see it was declining from the '02 level - 1.2 billion is for the restructuring charges and ultimate payments as a result of the merger, dropping down to 247 million in '05, and now we're calling for it to increase in '06 to about $1 billion, and this will represent largely all of the cash flow associated with the July restructuring announcement.

There will only be about 100 million that's expected to carry over into '07. Next, capital expenditures. Capital spending at the gross level has been fairly steady for the last several years, right around the 2 billion level. We have had very healthy proceeds from the sale of capital assets, around the 500 to 600 million a year, and so you can see net CapEx has also been fairly steady.

That's going to change a bit in '06. The past couple of years, the key drivers of our capital spending were IPG, where we're adding capacity through our supplies lines, and our financial services business, where we have a regular turnover of capital that we then put out on lease programs. In '06, you're going to see the impact that Mark mentioned in IT. We're going to go through major transformation of our IT capabilities, and as a result we will have heavy capital spending, not only for '06, but for a couple of years beyond that as well.

So we are calling for a total gross capital spending of 2.8 billion, net CapEx of 2.2. So these will have a major impact on cash flow. So, if we put all that together now, looking forward to '06, here you see our cash flow statement, starting with operating cash flow, expected to be in the 7.5 to 8.5 billion range, net CapEx of 2.2 billion, so free cash flow of 5.3 to 6.3 billion for '06, down somewhat from the very strong levels we achieved in '05, but still a very healthy level, particularly when you keep in mind that that assumes that we will be spending 1 billion of that on restructuring payments.

At the bottom of these charts, we have just noted the items that we have included in operating cash flow is above (ph). Acquisitions is another use of cash. The chart on the left shows you the last two years of acquisition cash use, 1.1 billion and then dropping to 641 million '05. We have of course closed the Scitex transaction in Q1, and expect to close Peregrine. Those two will amount to a cash usage of about 650 million in Q1 alone.

So you should expect, going forward, some level of acquisition cash use in the range of the 600 million to in excess of $1 billion. To the far right, I've shown you the revenue impacts of these acquisitions, and I won't take you through the whole thing. The key takeaway is that while we have spent these amounts of money, it has not had a significant amount of impact on our revenue growth rates. Revenue growth before acquisition effects and after acquisition effects both amount to 8%.

If you do, though, look at a couple of the businesses, services and software, whereas the main action has been there was an impact on revenue growth rates. Another key use of cash, of course, is if we don't need to invest in the business is to return it to shareholders, and this shows the multiyear trend on our dividends, which have amounted to a little bit under $1 billion per

year the last several years, and of course share repurchases amounting to 3.3 billion in '04 with the accelerated purchase program of Q4 '04, and 3.5 billion spent on share repurchases in '05, with bigger amounts being deployed later in the year.

Importantly, we entered '06 with 3.4 billion of share repurchase authorization still outstanding. So, all of these actions then translate into these kinds of cash balances. Gross cash in the 13 to $15 billion range the last couple of years, gross cash per share, amounting to about $5 per share as we exit '05. Net cash, 8.7 billion, and very nice growth in net cash of $2.8 billion growth in '05. The difference between these two bars, of course, is debt. That has reduced a little bit, shrunk a little bit, amounts to about $5.2 billion in debt outstanding as we exited '05, all of that attributable to debt needed to fund our financing receivables.

So we exit '05 in good shape, strong cash balances, which benefit of course from the strong cash flows. So, finally, capital allocation. We want to use our capital to invest in the business when it makes sense to do so. Mark indicated the focus on growth and efficiency. We spent capital on capital expenditures, I just reviewed that with you, be it to support IPG supply lines, our financing business, or now to drive efficiencies in IT. IT investments will be substantial going forward the next couple of years, but they provide excellent returns on investment for that spending.

Beyond that, we invest in the business organically. We invest in R&D to drive growth. We invest in sales resources to take advantage of market growth opportunities, and we invest in marketing opportunities to do the same. We invest money in other parts of the business to take cost out, just as we are spending capital in the case of IT. And we invest capital to drive organic growth. Can't predict how much we'll do, or when that will occur, as it really depends upon the opportunities, but you should assume that we will continue to deploy capital in M&A transactions to acquire technologies and to continue to consolidate the industry.

If we have good uses of cash, we will invest in the business. If we have cash beyond that, we will return it to shareholders, as we have been in the form of dividends and share repurchases, and while I cannot tell you how much we will spend on share repurchases, I just will say that it is our goal to at least offset the dilution from employee option and share ownership programs.

So, finally, in summary, we achieved strong constant currency revenue growth. We continue to see healthy recurring revenues. We've seen nice improvements in margins in a number of businesses, and thus we have a much better of balance of profitability in our portfolio of businesses today. We've achieved strong EPS growth the last couple of years, 22% growth this past year. And we have significant strong cash flows, and of course a very healthy balance sheet. We are investing capital to drive growths and to improve shareholder returns, and we will return capital to shareholders through share repurchases and dividends on a going-forward basis.

So that concludes my financial review. You'll be hearing from the businesses on how they're going to make all of this happen on a going-forward basis, and at this point we're going to go to a Q&A, so Mark will join me here on stage.

QUESTIONS AND ANSWERS

Ben Reitzes - *UBS - Analyst*

Hi, it's Ben Reitzes from UBS. Mark, could you give me some impressions, get us some impressions of what could perhaps make your operating margin targets conservative, based on some of your initiatives that are ongoing, or puts and takes that could change that either way, and what you're worried about?

Mark Hurd - *Hewlett-Packard - President and CEO*

I wouldn't react to the conservative comment. I think we try to give a fair view of what we think will be the results of our initiatives. I think clearly the levers are pretty simple - how fast do we grow the company. If we grow the company faster, the probability

we'll have better performance. Clearly, the mix of that growth and how that portrays within the portfolio has an impact on our gross margin, so it won't be just important if we grow faster, but how we grow faster and where we grow faster.

We're clearly going to have to play on the typical levels of pricing discipline and other things as well. The cost initiatives that we've described we think will land us at roughly that destination, but I'm not going to tell you that we're done from a cost perspective. Now, one thing I would point out, and that is that the majority of our cost isn't in OpEx. The majority of our cost is above the gross margin line, so we'll continue to drive on those levers as well.

But, again, we have a lot to do. We realize that. We can clearly do better than how we've been doing, and I think given what we see happening, particularly as you're referring to '06 and to '07, we believe these are fair estimates of where we should land.

Ben Reitzes - *UBS - Analyst*

One last thing is just I've been surprised, you've changed some of your practices in the channel. I've been surprised to see no disruptions really whatever. You've changed some things to enhance your margins and create solution sales, et cetera. Could you just talk about what you did when you got in there to HP to change this program and how it's going, and where it's going?

Mark Hurd - *Hewlett-Packard - President and CEO*

Well, let me say one more time. This is not a one-person act at HP. There's a lot of people that were working on this in advance of my coming, so it wasn't like things changed on March 29th. But the thesis around it is the fact that all partners aren't necessarily equal, and we have this binary distinction of direct versus indirect, and the objective we've had is to really say let's focus and segment our partners by how they play and where they add value. And, to your point, we have partners that do - I'll play two extremes for you. We have a partner who would take an HP-badged product and they would take that product, and they would actually take HP parts out of that product, use those HP parts as service parts, put in gray market parts into that product and sell it as an HP-badged product.

Not extremely helpful, because it actually puts our brand in front of the customer with parts that aren't ours. They tend to fail more. We hold the accountability for that. We pay incentives and so forth around that behavior. At the same time, we have a partner who's investing their hard-earned money to actually take not just the box, but surround it with HP content, as well as their own content, and spending their own operating expenses to go to market. We want to incent more of that latter behavior, and we want to reward more of that behavior. So we want to look at our channel compensation the same way we would look at internal compensation - the better you perform, the more money you make. So the thesis is really that simple, and it's not that everybody is created the same.

Your point about disruption, I think when you explain it to the partner community in the context of performance, intellectually they generally net (ph). I won't tell you that everybody's loved it.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Yes, it's Toni Sacconaghi from Sanford Bernstein. I have two questions, please, Mark and Bob. The first one is, I appreciate the details on the operating model for 2007. Can you provide a perspective on how investors should think about your longer-term operating model? Should we be taking that 4 to 6% revenue growth and thinking that's a longer-term operating model? But if we look beyond that and look at the base, once you've baselined to 2007 as you've talked about it, Mark, what should investors be thinking about? Is it 4 to 6% top line? What direction does gross margin go, and what is the sustainable EPS that you can deliver going forward? And then I have one more, please.

Mark Hurd - *Hewlett-Packard - President and CEO*

Well, thank you, Toni. I appreciate that question. I think probably the best way to think about growth is it would not be our objective, Toni, to go out and lose market share. So when you think about how you should think about growth long run, a lot of that depends on the dynamics of the market, and I can't predict the macroeconomic trend. I can't predict many things, other than saying that we think we're well positioned in those core markets to grow in line with the market, or perhaps better. So I think that's the first point. I think the rest depends really on how those growth rates align relative to mix.

We'll continue to be disciplined relative to how we deal with our cost equation. In terms of giving you an '08, an '09, 2010 model, not what we're going to do today, Toni.

Bob Wayman - *Hewlett-Packard - CFO*

I think the only thing I would add, Toni, is margin pressures in this business have been around for a long time and they are likely to continue. So, if you look at longer-term plans, while we do everything we can to find healthy gross margin business, the underlying industry trends say you're going to have to continue to bring your OpEx structures down to match that kind of a force.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

That just relates to the second question, which is probably just a follow-up to that statement, Bob. It does sound like, given the margin pressures going forward, taking cost out of HP is a continuous objective. To that end, you have been not including restructuring expenses in your reported non-GAAP earnings. You've had them for 11 out of the last 12 quarters. It sounds like you're going to continue to have them on a go-forward basis. How will you treat restructuring expenses going forward? Are they excluded from non-GAAP earnings, and what's your thinking on it given that it does appear that they are ongoing rather than one time?

Bob Wayman - *Hewlett-Packard - CFO*

Well, it would be our intent to go back to where we were at the beginning of '05 and not adjust those out of non-GAAP once we get through this set of actions that have been announced in July. I can't tell you we won't ever do it again. It kind of depends. The advantage, in our mind, of pulling it out of non-GAAP is to allow you to see both with and without. To the extent it is small amounts on a regular basis, there's not much advantage of that. To the extent it's a big amount, as it was in this set of actions, we see an advantage in showing it both ways.

Keith Bachman - *Banc of America Securities - Analyst*

Good morning, Keith Bachman here from B of A. Mark, I have two questions, if I could. Focusing on the printer margins for a second, you've had a couple of quarters where you've been at the lower end of your range. Can you talk about some of the pushes and pulls there? Specifically, you've identified the high-end commercial market with Scitex and what have you. How does mix help and then some of the other forces, particularly with the low landings on the hardware side, continuing to look like it's under pressure.

Mark Hurd - *Hewlett-Packard - President and CEO*

So, I think there is pressure in some parts of the market, as you described, Keith. I do think that when you look at the model long run, our model is 4 to 6% growth, 13 to 15% operating margin, so that's the model that we pay, and that doesn't mean 13.001 or 14.999. It means a range of 13 to 15. I think what's important, though, for us is that we let IPG go do what it needs to do to

improve its position in the market within those ranges that I've described. So it's just as important to us that we are doing the right thing from a unit share perspective, particularly in some critical segments that give us an important recurring revenue, so that's a dimension.

You I think appropriately also mention that there's a commercial printing market out there that we think is a big market with opportunity for us. And you're going to see us both invest in that market, invest in salespeople and deploy salespeople to pursue that market as well. So I think you get roughly the range you should expect us to be in.

Keith Bachman - *Banc of America Securities - Analyst*

Okay, the second question relates to you talked about accountability across HP, more execution and better accountability. Can you give us a flavor, without necessarily specifics, on some of the compensation issues that you're thinking about to try to distill greater accountability through the HP workforce. How are you going to drive some of those initiatives to get the appropriate response from the breadth of the workforce.

Mark Hurd - *Hewlett-Packard - President and CEO*

Well, in a broader case, I don't believe compensation drives accountability and isolation singularly. Leadership drives accountability, and if we have a problem with that, we need to adjust. So, in the end of the day, we can do better than we're doing, and we need to improve the alignment in the company from a leadership perspective. I could come up with thousands of comp plans, but compensation, in he end, is only part of the equation. There's a lot to be said for leadership saying, I'm going to go do this, take ownership and accountability for doing it, and my view is rather simplistic about it. We try to simplify things. We clear with each other what we're going to go do, and then we expect people throughout the company to go execute upon that. And we'll wind compensation up as a supportive tool, but Keith, in the end, it can't be the tool.

Cindy Shell - *Morgan Cabot - Analyst*

Cindy Shell (ph) with Morgan Cabot (ph). Three questions for Mark. One is that you've put forth a goal of becoming really a more enterprise-computing-oriented company, catching up and being a leader there. You've got some formidable competitors that have had what appears from the outside to be a head start. What I'm curious about is you seem to be finding a lot of good things within HP that haven't been apparent and unleashing them. Do you think there's a lot there that just needs to be unleashed, or do you think there's really some catching up to do on the technology side? And then two more questions after that.

Mark Hurd - *Hewlett-Packard - President and CEO*

I think we just - particularly at the enterprise, Cindy, when you look kind of below the traditional mainframe and you look at leadership positions by market, I think we're actually pretty well positioned, both in the technology and particularly where the enterprise security market is headed. More importantly than perhaps where it precisely is today, so I think you're going to see a constant evolution towards industry-standard computing.

I think the leverage you have from an industry-standard server perspective, the leverage we have in the movement of mainframes to Unix, Unix to Linux, the leverage of that and the integration around the framework, systems management, I think you're going to see storage management, systems management, security management morph as an enterprise capability over the next five years as well. And I think when you go pull the covers off everybody and just look at raw technology - we could get into other dimensions, but raw technology, I don't think there's a company on the planet that has a lead on HP.

I would also tell you that there are very few companies, very few, that I believe are actually well positioned to go execute on that opportunity, because I think at the core of it, you've got to have technology. If you do it just trying to shove around labor as your only differentiation, I think you're going to have a bit of an issue. So, in the end, to be good at the services game, to be good at the industry standard game, aligning the software around it, at your core has to be technology.

Which, I'd argue whether you're the leader, in the end, the number of people that can truly play at a level of scale globally, it comes down to a pretty short list.

Cindy Shell - *Morgan Cabot - Analyst*

And my second question, I understand from my industry contacts that one of the two key metrics for the fiscal '06 employee bonus plan is revenue growth. We're not seeing a lot in the expectations, we just saw perhaps today an improvement there. Are you expecting any improvement from the bonus plan, or is that some potential for upside.

Mark Hurd - *Hewlett-Packard - President and CEO*

These are key contacts you have?

Cindy Shell - *Morgan Cabot - Analyst*

No comment.

Mark Hurd - *Hewlett-Packard - President and CEO*

So, we have a bonus plan in the company that tries to align the performance of the company around improving the performance of HP, and they align around some of the metrics. Examples of those would be revenue, profit improvement, and we would try to align those. We'd also, Cindy, try to make them as simple as we possibly could, as we did. I'm a believer that you can't solve every problem with a comp plan, so give people simple comp plans that they can understand what you're trying to get done and let them go execute it.

Cindy Shell - *Morgan Cabot - Analyst*

Well, my contacts say it's been well received. My final question for you is you put out ...

Mark Hurd - *Hewlett-Packard - President and CEO*

I'd like to find out who the contacts are.

Cindy Shell - *Morgan Cabot - Analyst*

No comment. Final question, you put up that your goal is to become a leading IT company. You're developing quite a reputation for having a measurable accountability, if you could explain how you define putting (ph) a key company, any sort of milestones you may have around that?

Mark Hurd - *Hewlett-Packard - President and CEO*

Well, I think in the end, leadership has multiple dimensions. I think they can be hard metrics. They're also softer metrics - are you leading from a technology perspective? Are you leading from an innovation perspective at the same time as you look at revenue metrics and things like that? So, I think underneath that, you obviously want to decompose that into share leadership positions, revenue positions, and for us it's just as important, particularly if you believe these trends are going to play out over a period of time as opposed to 12 months to 18 months, that we're actually leading from a market perspective, not just in revenue but in our ability to define the end state, so for us leadership has multiple dimensions, Cindy.

Unidentified Company Representative

I'd just make one comment. We've got about 400 people in the room, so if you wouldn't mind, please refrain from multipart questions so we can get through as many as possible.

Harry Blount - *Lehman Brothers - Analyst*

Hi, guys. Harry Blount from Lehman. Not to put too fine a tooth on this comb, but, Bob, the FY '07 targets you put up would suggest the $2.25 earnings per share just by rough calculations. And just to clarify, is that exclusive of the restructuring components that you were talking about, your goal to try to narrow this so you have a single reporting line?

Bob Wayman - *Hewlett-Packard - CFO*

So, first, Harry, when I run the midpoint of those numbers I do not get that as - those must be rough and high, or I've miscommunicated something.

Harry Blount - *Lehman Brothers - Analyst*

We take a look at the numbers just on the back, it looks like roughly we're talking about 93 to 96 billion or so in revenue in 2007.

Bob Wayman - *Hewlett-Packard - CFO*

I don't have my calculator here, so all I'll tell you is that myself and Brian and his team, we've gone over this numerous times, and we don't get that number, so we'll take you through the worksheets offline sometime. There is no additional material restructuring assumed in any of that. That is the 7.5 to 8% operating margin is after the impact of stock-based comp changes.

Harry Blount - *Lehman Brothers - Analyst*

So, excluding that, it looks like it's up to maybe five to two then, is the number I come up with then, excluding those issues.

Laura Conigliaro - *Goldman Sachs - Analyst*

Laura Conigliaro, Goldman Sachs. Acquisition question, please. You obviously have made it pretty clear that you are still interested in acquisitions, but you indicated in the past that you were mostly going to aim small, and given the fact that you are going to acquire, have you actually changed your interest in acquiring small still, or do you think you've gotten sufficiently over the baggage of your last large acquisition to think in bigger terms?

Mark Hurd - *Hewlett-Packard - President and CEO*

Laura, thanks so much. I think that you shouldn't take anything we've said today as a change in what I previously stated. First of all, I think acquisitions are a part, so for us we want to have acquisitions, and I think the behavior you've seen from us over the past several months is indicative of what you should expect. Clearly, we want to have acquisitions that align to the strategic framework that we're describing today.

Clearly, the spaces that we're interested in, you've seen us make an acquisition in the Blade space. We've made an acquisition in the storage space, both again very key components as we go at this enterprise strategy. We've made an acquisition, too, in the systems management space. We've made a Scitex acquisition. We made an acquisition that we actually announced today around some more Web print capability. So in the end, these are all aligned to the strategic framework that we've got. They're also digestible, manageable by us, so these are the kinds of things we'd expect.

I'll never say never to anything. There's always things that do occur and the world is dynamic and all those type things, but nothing that we've said today should be taken as a change in our direction.

Andrew Neff - *Bear Stearns - Analyst*

Andrew Neff with Bear Stearns. Bob, maybe you could just - over here, now (inaudible).

Mark Hurd - *Hewlett-Packard - President and CEO*

You need to speak directly into the microphone. Speaking to the side of it doesn't work.

Andrew Neff - *Bear Stearns - Analyst*

Okay, there we go. Just to follow-up on the financial question that was asked a moment ago, the numbers do work out to two to 2.24. Just want to make sure, are you trying to convey something different for '07. In other words, if you just take your ranges, it does work out to that. Are you implying that there's something else that you're trying to get to, if you're assuming just sort of work with those numbers. I just want to make sure you're not conveying something different heard.

Bob Wayman - *Hewlett-Packard - CFO*

Well, we're certainly not trying to convey something different, and we're not trying to convey that, so there's some misunderstanding. If you take our revenue guidance as our '06 revenue guidance and start with that, I believe it translates into a number lower than that. Is that correct, Brian? So maybe you're starting with a different '06? Now, collectively, the Street is at the high end of our '06 range, so I'm starting with the midpoint of our '06 guidance. That's why I went through that chart.

Andrew Neff - *Bear Stearns - Analyst*

And you're assuming for OI&E, you're assuming income for OI? Is that correct?

Bob Wayman - *Hewlett-Packard - CFO*

Yes.

David Wong - *AG Edwards - Analyst*

David Wong, AG Edwards. Two things on your FY '07 guidance. The first thing is your stock option compensation hits 12 to 14%, very close to the current level that you're running for FY '06. So, do you expect this to be fairly constant going forward as opposed to bringing down stock option compensation as time passes? And, secondly, also on that theme, when you had ESS of 6 to 8% operating margin for FY '07, so you don't expect to be able to make progress on enterprise margins over the next couple of years?

Bob Wayman - *Hewlett-Packard - CFO*

Well, again, start with the second part of the question. SS achieved 4.9 in '05, so it is progress from 4.9 to six to eight, so we are definitely expecting further progress in that business. Very hard to say what will happen with stock compensation on a going-forward basis. This is a decision that the board's comp committee has to make going forward. It's also influenced, of course, by stock price levels and many other things. So we're just not going to go beyond what I've said, $0.12 to $0.14 is our best guess for '07.

Mark Hurd - *Hewlett-Packard - President and CEO*

In the end, too, I'd just add on the stock compensation piece, we will work to be as effective as we can at managing our overhang, so it is not our objective to create a negative situation due to that. We have dynamics around the price of the stock that causes us to make estimates, and I think the estimate is fair given the dynamics that we see in our models, so that's where we are. But I wouldn't want you to take from it we're going to run away from a share or a stock option perspective. That is clearly not our intent.

Bill Shope - *J.P. Morgan - Analyst*

Bill Shope, J.P. Morgan. Looking at the target '07 model once again, it looks like the drag on the margins is really from TSG. Do you believe that 3 to 4% operating margin range is line with the benchmark? Would there still be work to do there? And if that is in line with the benchmarks, or your benchmarks, and it's going to be a consistent drag on overall operating margins, can you comment, Mark, on what you think the strategic importance of PCs are to your portfolio over the long term?

Mark Hurd - *Hewlett-Packard - President and CEO*

Sure. I mean, I think that, again, there is a lot of opportunity to base this business to the next (ph). I mean, first of all, when you look at the benchmark, that's where we see '07, point one. Point two, I'm not here to tell you that in '07 that we still don't have work to do in the company. We've got a lot of things to do to get the company to be as good as I hope it can be over the long run.

So, I think based on the '07 discussion, I don't think you should look at '07, and then people are planning on leaving the building. So it's a dynamic process for us to try to improve the company. To your question about the PC business. I think having the discussion about PC operating margin in isolation, and then saying, I'm going to chop off that revenue and that operating performance and therefore everything else will be as it is I think would be a false strategic premise, because the leverage that the PC business brings us is significant in multiple ways.

It gives us significant cost of goods sold leverage, it brings importance to us in our industry standard server business, certainly leverages our ability to be more flexible in our supply chain, our ability - procurement leverage that we bring across the company. So, again, I think having these discussions in isolation would be an issue. We wouldn't have the relationships with some of the key partners we have without the PC business and we've got customers that like the fact they leverage the entire portfolio across the company.

So, I don't think it's again as simplistic a conversation as I like this, I don't like this, change this, everything else is the same. I think it's a more integrated conversation, and I do believe the PC business brings leverage to Hewlett Packard.

Bob Wayman - *Hewlett-Packard - CFO*

I would add that operating margin is not the most important metric in evaluating the contribution of a business. PSG, for example, is a very low capital user within the company compared to some others, so we're quite happy with our range of operating margins. We're certainly happier with higher ones than lower ones, but at 3 to 4% operating margin, this is a positive EVA contributor for the company, and so of course we will drive for further improvements, but it is not something that is a concern from a shareholder value point of view.

Unidentified Audience Member

Wanda (inaudible), Investment (ph) Group. Mark, you have mentioned you're focusing sales and marketing support and the direct and indirect channels. HP has been always challenged in how they intersect all these pieces together within various changes in organization. I know you did extensive work into your VARs and resellers to try to come up with more aligned and focused point of presence (ph) with the customer. Could you give us more of your thinking and philosophy about this area, since it's been a challenge area for HP for a long time because of all their diverse product offerings and support and et cetera.

Mark Hurd - *Hewlett-Packard - President and CEO*

Look, there is complexity to it. I believe we've added complexity to it, and I believe we can simplify our processes, simplify our relationships, simplify our go-to-market model, and that's what we're going to do. And I think in the end, clearly there's issues, there can be distribution issues, there can be deployment issues, there can be capability issues and there can be compensation issues. All of these things are resolvable, and I believe there are things that when management puts its mind to it, simplifies objectives, aligns resource appropriately and gives clear messages both to our sales force and to our partners about what we want to get done. I think you can see improvement, and it's a necessary thing for us to improve.

This is not, to be very blunt with you, this has not been our core competency. So, when you look at the evolution of the go-to-market models, we have opportunities to improve, and that's what we're going to do.

Bill Fearnley - *FTN Midwest Securities - Analyst*

Good morning, Bill Fearnley, FTN Midwest Securities. A quick question for you on PCs. You operating margins are up. You are gaining incremental share here. What are the key drivers in your view? Is it pricing, is it products, is it upsell? And is there a certain element there of competitive weakness as well from some of your main competitors in the category? What do you think are the big drivers in the PC improvement?

Mark Hurd - *Hewlett-Packard - President and CEO*

Well, it might be a better question for you to give Todd when he's up a little later. You're going to get a crack at him. I think there's all kinds of opportunities. You mentioned just some of the levers. Clearly, there's opportunities in pricing, and clearly there's efforts with us, buyers, there is service integration we can bring. So there is clearly a suite of levers that we can pull in the PC business. At the same time, it's a competitive business, so I think I'd probably ask you to defer to when you can get Todd up here and ask that question and get his response.

Brian Humphries - *Hewlett-Packard - VP, IR*

We'll take two more questions.

Unidentified Audience Member

(inaudible - microphone unavailable). Mark, you talked about building an enterprise data model.

Mark Hurd - *Hewlett-Packard - President and CEO*

Where are you, Richard? There you are.

Unidentified Audience Member

You talked about an enterprise data model. Arguably, you're well qualified to do that given your background at Teradata. You also have Randy Mott on the executive team now. Can you talk a little bit about what you are trying to accomplish there, how it's different from what you have now and how we can think about that affecting the financial model?

Mark Hurd - *Hewlett-Packard - President and CEO*

Sure. I think what happened at HP is not uncommon, or what happens in any scaled large enterprise is there's a strong thirst for analytic data, and I think people look at the quickest way to get analytic data, which creates this term called data mark (ph), which is the ability to take a piece of your data and then analyze it. It's, again, common.

I think we see the opportunity to look across the enterprise, so when I think of information, I don't think of it as the asset of a product line or a division, I think of an asset of the company, and when I think an architecture like a data mark architecture, I think of a very expensive, cumbersome architecture that in the end doesn't yield optimal information. So, in the end, I think we have the opportunity to integrate that information, understand the corollaries between that information, and frankly a big part of it is our ability to leverage our customer base.

I mean, the sheer opportunity that we have with the information that we do have to do a better job servicing our customer is a big opportunity for us. At the same time is I think we can get cost out. So to your point, we're going through the work right now, which is the most important part, which is to build that model. That's really the toughest job, and building great information starts with leadership, the leadership has to say it's important to do. You have to grow processes right, which is the data modeling process, and then we'll get technology to support that, so that's where we're headed.

Unidentified Audience Member

So is it fair to say that the benefits that you expect to receive from that are really just beginning, yet to be incorporated?

Mark Hurd - *Hewlett-Packard - President and CEO*

Just beginning. I mean, we would - I won't quote the CIO, because he gets a little nervous when I start doing that, but we would be looking forward to sometime middle of '06 as beginning to be better at all of this.

Unidentified Audience Member

And quantification of how you think that will affect either cost savings or revenue growth?

Mark Hurd - *Hewlett-Packard - President and CEO*

Certainly nothing I'd want to tell you about, but I appreciate the question.

Unidentified Audience Member

Thanks.

Rebecca Runkle - *Morgan Stanley - Analyst*

Thank you. Rebecca Runkle, Morgan Stanley. Just a follow-up as it relates to that to a large degree, Mark and Bob. You talked about increasing CapEx to the tune of about 50% on the net side in '06. I would imagine that a bulk of that has to do with the data warehousing that you alluded to, Mark, but could you just provide some more context in terms of what the increased investment is going to as it relates to internal systems and structures, and where the priorities are?

Mark Hurd - *Hewlett-Packard - President and CEO*

Sure. Where are you, Rebecca?

Rebecca Runkle - *Morgan Stanley - Analyst*

Way back here.

Mark Hurd - *Hewlett-Packard - President and CEO*

Oh, way back, okay. A couple things. One is that I wouldn't call the enterprise data warehouses singularly a driver of it, but really is when you have the number of data centers that we have, we have to send money to build the new data centers at the same time as we collapse the old data centers, and we actually have to build the new ones as we're closing the old ones, so it's a process that we have to go through. And with that, we'll be buying new infrastructure, so as we outfit those data centers. So with that is some real estate cost, some capital requirements for equipment that go along with it, and the EDW, as you described it, is a piece of it.

There are some other capital requirements that go with other parts of the enterprise that are really the rationalization, an '04 capital spend to an '06 capital spend that had a bit of a dip in '05, things like that, but IT would be a significant consumer of that increased capital in '06.

One more, or do you want to leave it at that?

Brian Humphries - *Hewlett-Packard - VP, IR*

I think we should leave it at that.

Mark Hurd - *Hewlett-Packard - President and CEO*

Okay. Why don't we with that introduce Ann? Ann is going to take you through TSG.

PRESENTATION

Ann Livermore - *Hewlett-Packard - EVP, Technology Systems Group*

Good morning. I am going to give you an update today of the Technology Solutions Group, so let's dive right in. In FY '05, TSG represented about $33 billion of revenue, and we were very pleased during the year that we were able to grow our revenue about 12%, but have operating profit grow 48%. This is the result of a lot of hard work done around our cost structure, reducing operating expenses, but also a lot of work on margin expansion.

This is particularly true in our enterprise server and storage business. Scott Stallid (ph) and his team are here. They really drove this action for us. They'll be available during lunch to be able to answer any very specific questions you may have, but basically we worked hard to reduce R&D expenses and sales expenses in ESS. We also worked on margin improvement through a number of very key programs, improving our tax rate, improving our pricing and discount, being able to have more of our business go direct and also working on our mix. Another major achievement for us last year was our software business.

We committed to you we'd be profitable in the fourth quarter. We achieved that. As we go forward, you're going to see us continue to work to lower the breakeven level in this business, and on top of that, to further grow all the new revenue areas that we were able to acquire through our M&A activities. In our services business, we've made good progress, still a lot of work to do, particularly around our labor costs and labor productivity. This is such an important part of the portfolio for TSG that we decided today to have Steve Smith do a deep dive for you on this business. I hired Steve into HP about a year ago to run our managed services business.

We promoted him during the summer to take on all of HP services, and he's going to give you quite a bit of detail around what we're doing in that business to really position ourselves to deliver against the 8 to 10% operating profit we laid out as part of the '07 plan. More and more you'll see us as we go forward continue to focus on driving the improvements in each of these individual lines of business, but also taking advantage of the portfolio that we have, driving these pieces together to deliver good solutions to our customers. You'll also see us, as Mark mentioned, really focused on improving our coverage model from a sales perspective.

If you look at the numbers for last year, you're familiar with these. In ESS, we committed to you we'd deliver 4.0 operating profit. We did 4.9. On the software business, you can see the results for the year. Bob reviewed these earlier, and also for HP Services, the results here, and again, Steve will give you more detail on this area. When we look forward, we see more and more customers who are trying to reduce the number of IT partners that they work with, so again, this plays to our portfolio, where we can offer a broader solution.

You can also see here how our portfolio is very important, because any particular piece of it drives growth in the other aspect, so we're going to work more and more on selling more of our portfolio together. This is the best and most efficient way for us to grow revenue. These are some examples of customer problems that we address today, five big customer pain points that is part of our adaptive enterprise offering that we offer solutions to. And you can see in this chart how we pull across our servers, our storage, our software, to deliver these solutions. Continuity, keeping an environment up and running and available - consolidation, whether it's server consolidation, storage consolidation or data center consolidation, control. It's all about helping an organization get better control of their IT environment to allow them to drive down cost and improve quality.

Compliance, a very big issue for many of our customers, where they have SEC and other regulations that require them, for example, to do things with e-mail or voicemail retention and easy retrievals. And then finally, collaboration solutions, pulling on other parts of the HP product portfolios in addition to our services capabilities.

So these are just examples for you of today how we sell all the pieces of the TSG and broader HP portfolios to deliver solutions to our customers. Mark introduced to you our plans around the next generation data center. We believe that this is a very, very important opportunity for us. Most of our customers today are dealing with high cost islands of IT, and what they want to be able to move to is to have lower-cost environments where their resources are pooled.

The main problem we're trying to help them solve, utilization today of most servers and storage products are around 20%. If you look as well at what's happening over the next three years, the predictions from all of the industry analysts are that spending on management and operations is going to grow three times faster than a CIO's spending on the products and technology that they buy.

So, as a result of that, we want to be able to help them be able to automate the IT operations to reduce the costs, but also to take out the human error. You can see across the bottom of the slide what are the key enablers of being able to do this. First, having scalable servers and storage products, built on industry standards, being able to add to that management capabilities, the security that's required, the virtualization of the assets to drive up utilization, and finally the automation of many of these labor-intensive processes. We believe that the promise we can deliver on is going from today, where the average is one technician for 20 servers to go to one to 200. One, for two terabytes of data, up to one to 200 - dramatic labor savings and also quality improvements.

So this is really driving our strategy across all of TSG. If you look at our portfolios, this really plays to the strength of our portfolios. Clearly, software is an integral component with the management software and automation software right at the center of it. The services, to be able to work with the customer in different fashions to deliver it, the leverage of our management software into our managed services business, so that all the investments we do for software we leverage into our services organization, our servers and storage as the product.

And, finally, you've heard the comments about being able to have our HP Labs help us drive innovation, and Randy Mott, being one of the world's most demanding CIOs, having our own IT organization test it, use it, drive it, help us innovate around it.

I'm going to take each of these areas now of the portfolio and tell you a little bit more, and I hope what you take away from this is we're positioned well for the future as we look at what's happening with the next generation data center and the market trends, but there's also a lot of stuff that we can sell today that's currently in our portfolio that helps customers begin taking these steps.

So, first with software, clearly a critical component of this. If you look at HP OpenView today, it's being used in 90% of the Fortune 100 companies, and we've deployed quite an ecosystem around it. We have 1,000 consultants inside HP who are experts on this, working with our customers, but then on top of that, we've trained 60,000 IT professionals in the industry, and that's critical when you have software that you want to have become pervasive. You can see on this chart the focus that we've laid out for what we're doing with HP OpenView. At the bottom, you can see the infrastructure, management and optimization, the end-to-end network and system management, as well as the application management.

You can see in the middle layer the IT process automation, with a particular focus around service depth, and also around change of configuration management, and then across the top, making the linkage between the performance of the IT with business metrics that the organization cares about, so this might be IT governance reporting and analysis, or it might be being able to report on a business process, the health of a business process that's supported by the IT.

Now, if you look at what we've done over the last couple of years, you're familiar with, and have heard us make a couple of point announcements of software acquisitions. You can see on this chart how they play to this portfolio. We've made very deliberate

acquisitions and also very focused internal R&D so that HP can fill out this chart better than any of our competitors at addressing the needs from a management perspective, and you know our two most recent acquisitions, Peregrine around asset management and Trustgenix around federated identity management.

If you look at services, a critical component of our portfolios, and we work our customers in different ways, depending on the assistance they need. Some customers want to buy the products and technology and do it themselves and just have us provide basic support around the product. Other customers want us to provide some design and implementation services through our consulting organization, to help them with the implementation, and then they want to run it themselves. And still others want to outsource some piece, or perhaps all of the management to HP so that we take on the responsibility of helping them transform to this next generation data center.

The important thing is we can work all of these ways, and with many customers, individual customers, they want us to interact with them in each of these ways just for one particular customer. Storage is clearly a very important part of our delivery of this value. If you look at storage, the growth rates around information about 30% a year. IDC is predicting that in terms of storage consumption, it's going to be 15 million terabytes over the next five years.

That really says, we want to have some great products to sell into that market opportunity. You can see here are our offerings going from the MSA, our low-end, very simple, affordable product, often sold in an industry standard type environment, our EVA or midrange, regarded in the industry as the easiest to configure, install and manage, and then the high end with XP, where we really have our fault-tolerant, always-available solution, with a very strong implementation of tiered storage capabilities.

You can see the notes across the bottom around software and the areas where we're investing. Storage today is more than just storing stuff. It's about being able to use the data, being able to index it, being able to archive it, being able to retrieve it and being able to manage it. So we're investing in storage software to help with these parts of the solution. You saw the acquisition we made of AppIQ around storage resource management, a year ago, the acquisition we made of Persist around the ability to be able to do information life cycle management solutions with the archiving and rapid retrieval, particularly around e-mail and voicemail-type solutions.

We'll continue to invest both organically and inorganically in the storage base to have the differentiation we need. A year ago, I stood in front of you and told we weren't satisfied with how we were doing in the storage business, that we had work to do both in the sales activities, as well as our product portfolios. We're pleased with the products we made over the last year. The team executed very well. If we look just at the fourth quarter, our storage business grew 17% in terms of the revenue growth. On the high end, our XP grew 32%, we made good progress with our sales and channel activities, a lot of work done, but still a lot of work to do.

We also made significant announcements and enhancements in our entire product offering. You know last May we had a mega set of announcements of products and services on storage. We're seeing the results of that now in our financials. Just in the fourth quarter, the EVA grew 44%, really speaking to the very strong customer reception to these new products.

We'll continue to stay very focused on ensuring our products are competitive, again, organically and inorganically. AppIQ, our most recent acquisition, already integrated to become part of Storage Essentials and part of our System Insight Manager. You'll also see on this slide an important factor as you analyze our business. Our mix is quite different than the market. The orange bar that you see is the tape business. This is a slow to negative-growth business, very large for us, also very profitable, with a very attractive media business.

So we love this business, but it dampens our overall revenue growth compared to some of our competitors. You can also see here our relatively small position in software, which we'll be focusing on expanding, and also around NAS, which is the green bar, really moved from eight to third. We still have work to do.

Servers are a critical part of our portfolio. We're very pleased with the hand we have in the server business. Today, one out of every three servers that ships as an HP server, we've led in shipments for many quarters in a row, and we have the number one market share position in Unix, in Linux, and in Windows. And this is very important for us, because these are the forward-going operating environments that really matter. We're pleased that our profitability is not dependent on the mainframe business but instead is dependent on these businesses where the future growth and the future implementations are going to be.

If you look at the chart, you can see the projected growth rates, and again, we feel like this really plays to our hand. The Unix business continues to be attractive to us, but it's a flat business, where we have industry leadership around X86, you see good growth rates, the fastest growth rates around the Blades part of the X86 market.

The ProLiant. HP ships the ProLiant server very 14 seconds. We know how to do volume servers and we're doing them well. We continue to lead from a technology and product offering perspective. We have very strong management capabilities in this space, and we've done a good job over the last year increasing our average unit prices and also increasing the margins around this business. We'll continue to stay focused on that, and as a result of that, you're going to see us spending more and more time focused on revenue share, not just unit share, and this is because we believe it's a better reflection of a good balance between profits and revenues. And we're going to continue to drive that very aggressively.

Blades. Blades is, as you saw on the chart, the fastest-growing part of the market. The customer attractiveness has to do with the extreme modularity, the value proposition being that it really reduces the time and the cost of implementation, and then it's easier to virtualize these resources and be able to have a better matching of supply and demand from a Blades perspective. Again, we think this is a very strong market trend, and it plays well to HP's capabilities. Why? In the Blades business, it's a combination of a value sale, but with volume components.

You have to be able to do the kind of high-end system sale and services that you do with a mission-critical server, and yet you have to have the cost structure for the components, the server components, the management components, the storage component, the services implementation, that's needed in the volume business.

So, being strong in both of these business areas for servers is really helping our business model and position from a Blades perspective.

HP Integrity. Many of you have had questions and have really probed us on Integrity, and asked us in particular about Itanium, so we wanted to take a few minutes to be able to discuss this with you, because it's clearly a critical part of our overall portfolios. If you look at our FY '05 results, we saw very strong revenue growth. We're pleased with the growth year over year, 81%. It now represents about a quarter of our revenue in our high-end server business. We're very pleased to see the growth across multiple operating systems. Clearly, the strongest growth around Unix, but we're also seeing growth around Linux, Windows, OpenVMS, and we've announced products around the NonStop as well, for our Integrity line.

More important than any of this, and the real test of the acceptance in the marketplace is what are customers doing, and we've seen over half of the Fortune 100 already have our Integrity servers in deployment in mission critical applications and database implementations, so over half of them. We have the largest SAP deployment in the world running on Integrity, and that's at General Mills. We have the largest implementation of PeopleSoft in the world, running on HP Integrity. We have several of the largest Microsoft SQL implementations in the world running on Integrity. We have 500 customers who've installed SAP systems running on Integrity. So this really speaks to the customer acceptance, which is the real test of any systems offering.

By the end of the year, we're going to have 6,000 applications available. This is almost twice what we had this time last year as we talked to you about Integrity. We've got built into our business model the investment that's necessary to drive this program forward and to be able to lead in this space. And as we look broadly at the server market, what you're going to see over the next few years is clearly X86 as an architecture, and then two high-end system architectures, Power and Itanium. We've made our bet for the high-end part of our architecture with the largest microprocessor company in the world teamed up along with us to make those investments.

We're fully committed, as is Intel, to this marketplace. We're pleased with the progress and you'll see us continue as we move into FY '06, be very aggressive and focused on growing this part of our business.

R&D innovations are very critical to our next generation data center, and on this slide you can begin to see the advantages of what we've done with our microprocessor strategy, and you can see the R&D investments we've been able to free up to be able to instead put in Blades, to put in management software, virtualization software, automation into our storage line of business, and this is very important for HP, to be able to take these funds and instead not focus on just the microprocessor technology ourselves, but instead to be able to put that into technology which is really going to be differentiating from a customer perspective.

Again, if we look at our portfolio, and this is quite consistent with the comments you heard Mark make earlier today, we're leveraging the assets that HP has, and we really believe that the market trends that are painting the future of what's happening in computing play to our hands. You're going to see us build, as we have done for many years, on top of industry standards products and services. You'll see us add differentiating technologies that are critical to helping customers drive up utilization and drive down labor costs. You'll see us make those investments again around the management technologies, the automation, virtualization technologies.

Then you'll see us leverage all of those investments that we make, particularly in software and our servers and our storage back into our services business, as technologies that we use to automate service delivery so that our services organization may not need to be the biggest, but they can clearly have the best weapons of any other organization in the space.

So you'll see us really leverage these investments across our portfolio with the help of HP Labs and the testing of HP IT. So I spent most of my time today talking about the future, but I hope what you can see is we're well positioned for the future, but much of what's going to play out in the future we can already use today our portfolios to sell the Blades, the storage, the server position, the services position we have, the software position we have, and we're going to continue to drive this forward.

I haven't spent much time today talking about our go-to-market activities, but you heard from Mark, you'll hear from my team, we're driving on those areas as areas that we need to make improvements this year to really benefit our business. You're going to continue to see us be relentlessly focused around cost reduction, both in the OpEx categories, as well as in our cost of goods sold and our services delivery, and, finally, to be able to really take advantage of leveraging all the power that we have in our portfolio as a real competitive advantage.

Now, to give you a sense of that power of the portfolio, we're going to transition now, have Steve Smith come up, do his deep dive into the services business and be able to share with you the things that we're doing there. I think you'll get a really good sense as to how this fits in with the things we're doing overall well inside TSG.

So, Steve, I'd like to turn it over to you now. Thanks.

Mark Hurd - *Hewlett-Packard - President and CEO*

Actually, we're going to change the order just a minute here.

Ann Livermore - *Hewlett-Packard - EVP, Technology Systems Group*

Oh, we're going to have a change. It's not going to be Steve.

Mark Hurd - *Hewlett-Packard - President and CEO*

Oh, he's going to be here in just a moment, but you can head back there. Just to try and clarify, if we take back the '07 outlook there, electronics, we're getting all kinds of messages here about what we're trying to communicate. If you take the midpoint of the revenue growth range, and you take the midpoint of the operating margin range at the company level, these numbers translate into about $2.12, which is slightly above the current market consensus of $2.09. This, both the consensus and our $2.12, include stock option expense in expenses, so that it already reflects all of that.

Now, there is a range and you can come numbers lower than that and numbers higher than that, but that is what we are communicating in the '07 outlook chart. Hope that's helpful.

Steve?

Steve Smith - *Hewlett-Packard - SVP, HP Services*

Good morning. As Ann mentioned, I'm one of the new members of the leadership. I've been here coming up on my first year anniversary, and have been focused, as Ann mentioned, on half the year on our managed services business, and then the second half of the year focused on pulling together the new HPS, HP Services construct. And I'm going to give you a little bit of a view into that.

Most of the focus that we've been doing in the services business and around go-to-market, getting profitable growth focused in our consulting and our integration and in our managed services business, as well as operational readiness, as you heard Mark and Ann talk about this morning. Improving our performance discipline and achieving benchmark cost structure is at the top of our agenda.

So I'll give you a little bit more insight into that as we go through this this morning. Just to get context of the size of HP Services, here are some factoids to get everybody zoned in. This is a $15.5 billion business inside of HP that generated 1.2 billion of operating profit this year. It is multivendor in terms of the services we provide across all of our business groups. We have almost half the population in the company in the services organization, deployed in about 170 countries. We are positioned, as you heard about, and I'll give you some more insight into the market trends. We range, as you've also heard, from a consulting and integration competence, through a technology support competence that's wrapped around all our business groups, to full IPO, BPO outsourcing.

We're also very closely aligned with our R&D spend. We're making that connection much tighter as we speak. The secret sauce is testing our IP. We're bringing alive and getting it connected to our offerings, and I'll give you a little view of that. Reducing cost is the main driver to drive future growth and margin expansion, and gain, to context this thing, HP Services, roughly the same size as Accenture, a little bit bigger than CSC, so this is a very prominent, large organization.

From a financial perspective, we achieved above market growth revenue growth rate in '05, assisted of course by currency and acquisitions. I think the two that you would recognize would be our Cinstar (ph) and Triaton acquisitions, both low-cost delivery vehicles that we're leveraging outside of those regions.

We did moderate our managed services growth last year to return this business to profitability, so we slowed it down the back half of the year. I think many of you know this business was growing 3.5, 4X the market growth rate. We probably back into this year had it down to 1.5 times market growth rate. We have had ongoing sequential operating margin improvements in both managed services and the consulting business. Actually, at the highest levels in the past two and three years respectively. And our '05 margins, as I think were mentioned earlier, were impacted by the workforce reduction the first half, as well as our significant bonus accrual in the second half.

So the focus is on absolute cost of service delivery. We're focused on this cost foundation to take this business forward, and I think if you look across the region in these businesses, we grew the fastest last year in Europe, followed by Asia and then the Americas, and inside of these three business, our consulting business was at about 12%, which was similar to the overall organization. Managed services still grew around 24%, so still a very high growth rate, even though we did slow it down as we got focused on profitability and our technology services grew in the order of magnitude of just under 9%.

You saw this slide earlier from Mark, and I guess the point I just want to leave you with today on this that as we look across all three of these business group trends, HP Services - you wouldn't typically see this chart from any of our competitors talking about what we see as a trend, but our starting point inside of HP is looking at the trends that our business groups start with. We wrap services around those. Our starting point and our ending point is really tightly linked with our business groups, and so we do feel like we're well positioned with these trends, whether it's next generation data center architecture or helping the mobility infrastructure deployment with Todd's business or the continued analog to digital implementation of the printing business.

We're tightly linked with all of them. As a matter of fact, VJ and I have put senior leadership on both our teams. It comes to work around the world every day just growing and looking for new opportunities between the printing and imaging group and the services organization. I guess the other point I'd leave you with here, Ann mentioned the labor issue of the automation at the end of the next generation data center architecture. For those of you who are familiar with the big outsourcing relationships and the high-end technology service relationships, human error still plays a huge part in service-level problems. And as we push down and these things are enabled, taking human error out of delivering service levels to our large global clients is a huge advantage that we have as we push on this. You saw this chart earlier, also, and I guess my point I want to highlight here, as I get into what these businesses are doing today is we can go all the way from fulfilling demand from a product orientation enabling demand and helping a client draw the blueprints to high-end outtasking all the way to full continuum of outsourcing where we actually take on the people, take on the assets and are held accountable to service levels.

So we do go end to end, it's a full continuum of offerings. Busy chart here and I don't want to dig into the offerings. But wanted to give you a context of how we go to market with our portfolio. You can see on the left side of the chart our technology management business is an infrastructure-based business. Very simply, this is where we deploy hardware, deploy software, warranty, maintain it, business continuity-type activity. This is a very large business, as you saw on the chart, almost a $10 billion business. This is highly leverageable and it is used in almost every part of the business that we deliver to our clients.

If you look below that, you'll see that it's a very large part of the portfolio, 62% of it, with a lower growth rate. In the middle, our consulting and integration business, we go up the stack. We can participate in infrastructure. We're very strong in infrastructure-based platforms like Linux, Unix and Microsoft, and in the application space, we're deep in .NET, moving deeper in Oracle and J2EE. And then we do play in the business process space.

Similarly, on the outsourcing side, we go all the way up the stack. And I would tell you, as Mark pointed out this morning, where we would go to adjacent markets. As long as we can connect any decision to our technology or to our R&D, we will move up the stack and look for opportunities in applications and business process. As many of you know, as I'll show you in a second, those markets are large and there's a lot of opportunity there.

But as you look at the bottom, you'll see the growth rates do vary across these businesses and our mix is quite different. This chart gives you a view of how we look at the market. It's not a surprise to many people in this room, the big orange circles represents the IP and BPO business, the blue represents the consulting, and we compared ourselves on the right side of the chart to how our competition is lined up. You can see again to point out that our starting point is very different here.

We start with a technology services business that generally at the beginning of every quarter, we start with almost $0.07 of EPS in our back pocket with the annuity revenue we have in our technology services business. That is very similar to the rest of the companies on that chart, which start with a backlog of their long-term relationships that they have with their outsourcing

contracts. We also have that if you look at the chart on our orange bar, a $3 billion outsourcing business that is pretty impressive, given that it really got into the tier one status just three, 3.5 years ago, and we're continuing to grow that business very rapidly.

But, if you looked across this, you can see the technology service business is at a lower growth rate. They are substantial markets. We are participating in all three of the markets, as you see, but the growth rates vary, and again, I just want to make sure we highlight the mix because our starting point is much different than our competition.

Complex chart, but I want to walk you across the top and then give you some highlights on the bottom here. The top is what we've been after since March, and the leadership team announced an operating model adjustment. We probably have the most work to do in HP Services at post-operating model announcement in July. We have three loosely coupled organizations. Again, these are large organizations, as you saw, that were going to market with different sales, different delivery and different portfolio of offerings.

To say that we were somewhat confusing is, as Mark alluded to, was a fact. We listened to our customers. We knew that we needed to simplify this thing, and we created an operating model on the right side that really started to create four things for us, a much simpler interface with our customers. So, around the world, in our regions, we had reorganized ourselves to reset ourselves up to interface with the market as HP Services.

It doesn't matter whether you want to engage a consulting, a technology service or a managed service-type offering, we now face off and it's a much simpler motion for us to our client base. Secondly, as you can imagine, the businesses have grown up with all the acquisitions here. We have - we are looking at refining the portfolio of offerings. We do have overlap in some of these offerings, and we again, over the last 100 days, were in the middle of refining the portfolio so we can simplify the offerings we take to the market.

Probably the biggest change we're making is making a significant investment in our global delivery platform. We are now at the point in our evolution where the amount of global customers that we're taking on are demanding that they get to see their business send to end, so we have built into our plan the ability to invest in tools, methodologies and processes to make sure that we can help big global clients see HP look and feel the same around the world. So we're making that investment. We're underpinning the entire HP Services organization with this global delivery function, not to say for region and country deals where they don't demand global delivery standardized offerings, then we will deliver the way we're doing that today.

But this is predominantly aimed at very large corporations that ask us to deploy around multiple countries around the world and we're making that next-level investment. If you look down below, there really are three big things we're focused on - cost structure and operating model refinement. And, as Ann mentioned, labor arbitrage has been going on in this corporation for the last five years. It is now moving into a combination of labor arbitrage and technology and automation, and so we can dynamically deploy resources. And so we will continue to do that and move a lot of work offshore as we grow this business.

Process standardization, internally, as well as delivering to our customers, may be one of the largest things we can to do help cost drop out of the bottom. We are doing things on the left side of the model three and four and five times that are now going to be streamlined into a single process so we can do it once, leverage the IP and get the benefit of that cost. And I've mentioned earlier, also, we will continue to stay very tightly linked to our R&D and to our portfolio leverage of the three business groups, two of which you are to hear from here shortly.

In the middle, our core portfolio, maniacally focused on increasing our attached. And our technology services business is wrapped around everything we do in this corporation as we deploy hardware, software and drive business continuity. So we're really focused on increasing our attached business and mining the installed base, as you heard Mark talk about earlier. So we have lots of initiatives, lots of programs, driving the accountability of that to really focus on end-of-life programs and almost having a 100% attach on everything we sell, so that a customer or a salesperson almost has to opt out versus trying to make a decision whether we should attach services.

We're also going to take a deeper dive into the financial services industry, into the banking sector. We have developed quite unique IP in this business. We're going to look hard at tier two and some lower-end tier one business banks that we really haven't been all that focused on and take a concerted effort into that segment. And then finally, on the right side here, as I mentioned earlier, as we look for opportunities, or as opportunities are presented to us, where it is tied to the core, where it is tied to a technology advantage, we will continue to go up the stack and (inaudible) BPO type opportunities outside of where we are very strong, in the finance and administration horizontal. As well as you'll hear VJ talk a little bit about managed print.

We have a huge asset in this corporation. We have been doing managed print business around the world in a pretty significant way. VJ's business and our business is going to take that to the next level, like we do with desktops, like we do with midrange, like we do with networks and the rest of the CIO spend inside of a corporation.

Next-generation data center, I'm not going to give you any more on that, and you know that's a deep focus for us, and as Mark mentioned, we will do targeted acquisitions that are very digestible, very manageable and that bring us either unique IP or can differentiate us as we go to the market. So a lot of good work going on here the last 100 days.

I would tell you, this thing is - the market and our customers are very happy that it's just easier to deal with and we're simplifying things for them. One minute on global delivery. I mentioned, and I wanted to show you a chart here to give you a sense of the complexity that's been mentioned here today on the left side in the orange box. Now, not surprising with all the acquisitions and the way we were deployed regionally in this business, we had some complexity in how we were doing global delivery. So, the transition we're making right now with the investment is to centrally run some large functions in this delivery. So the white boxes across the top are really big factories - data centers, call centers, BPO centers and application centers.

We're going to centrally run those with global leadership, deployed regionally, so we'll have a single end-to-end view for delivery of global customers. We'll take our tools, processes and technology, define them centrally and then execute globally, and this exercise alone will deliver significant cost reduction for us just in the simplification of how many times we do things, and reuse.

Cost reduction from this, from the standardized service offerings, we probably when we got into this business went too far to the customized offerings we were doing for customers. We were pretty much giving customers whatever they wanted. We're going to swing that pendulum back a little bit, have building blocks of standardized offerings. For our big global customers, we will wrap customized capability around it, but for a lot of country-based, region-based customers, building block-type approach is what most companies are doing today and we're well on our way to accomplishing that.

The four boxes underneath really give us consistency and we're managing huge amounts of data today for clients. We've got to secure it and make it compliant, standard and consistent service excellence is a requirement today to play. As you know, to be in the outsourcing and the services business, it's all about one thing, referencability.

If you can't point to where you've done it before, you're going to have a tough time winning a new client. So 100% referencability is a very large component of this. The last thing I would tell you here is I know you're most interested in how much of this work is offshore. A couple of numbers here for you that aren't on the chart. Today, across our nine largest offshore centers, we have approximately 19,000 people deployed in our nine largest centers. In India alone today, all in, HP, we're upwards of 18,000 people. One of the most impressive, and I've been in this business for upwards of 20 years now and all over the world, ran business in other companies in Asia, it's one of the biggest hidden secrets we have in this corporation today, how we do offshore applications and business process work. It is best in class in lots of ways, and we're going to put a go-to-market face on that as we grow this business.

So about 27% of our population, our services population, is in offshore centers, and we're growing that about 30% year on year. We'll grow that another 30% as we move through '06. Two more charts here. This is another eye chart. I don't want you to read this thing. I just want to leave you with a couple of points. As you heard Mark talk about this morning, there's a level of discipline and execution that has been stepped up in how we're running HP Services. For a lack of better terms, this is a scorecard we have in the hands of everybody on the leadership team.

It's metric. It's in our scorecards, we have a war room, centrally at headquarters deployed in satellites around the world. We are driving maniacally to drive these costs, improved processes and getting our sales velocity. And what I mean by sales velocity is we have a lot of deals in the pipeline that are sitting in there too long, and we're driving velocity to get them driven to closure or get out of spending money chasing them. So it's a matter of performance discipline, and we're well on our way to doing that.

And if you look inside of these threes businesses, I'll leave you with a couple thoughts on each one that are the biggest levers. If you look at our consulting business, this is a 12,000-person consulting firm. It's got to be one of the largest $2.8 billion consulting firms that's not as well positioned or known like the brand names you would think of. We will continue to focus on the pyramid of this organization and getting higher utilization, getting the realization of our senior people up, driving our country margins where they're underperforming to a standard performance level, and then ultimately getting more IP into this business.

As many of you know, the consulting business, the top-end consultants, the Bains, the Carneys, the McKenzies, it's about bringing intellectual property to the game. This is a technology-based consulting. We're world-class in integration and implementation, but there is an element of IP that we're going to introduce in the verticals as we go forward.

The technology services business, it's really about two things. It's really driving the cost out of the labor that we have in the delivery of this business. This is a people-intensive business, so we're going to work hard at that, increase our catch rate, mine the heck out of our installed base and really focus on growing this business as we spoke about.

And then in the managed services, we're going to continue to get the risk management that we need. These deal cycles are long. They're anywhere from six to 18 to 24 months long. They take dedicated teams of people. You have to really watch the assumptions as you're building these cost models, and we've put some rigor into how we're looking at these, driving deal discipline, making sure that when we sign up on these assumptions we can deliver. The deliverability of these big, long-term relationships deals are critical to make sure that what we sold, we can deliver. So we're driving an element of discipline into that. I guess thing I would tell you on the managed services business is it's really about the three Rs, I call it, referencability, reputation, which you heard this morning, and I can tell you only being here a year and having been in a pure play for 16 years, the reputation that we have to go do this kind of business is a tremendous advantage for this corporation. And we're going to leverage the heck out of it, so reputation and how we do superior relationship building is kind of the next level we're going to go after.

Relationships can differentiate you at the top end of the services business. If your price is off or your technical solution is off, and you have superior relationships, you'll find out that you're off and your customer will help you get that solved. So relationship superiority is key here. We're investing in that with our front-line sales force, and referencability is an absolute differentiator.

Last point I'll leave you with, as mentioned, the trends are in our favor. We're really excited about the linkage that we're tied to with our business groups. Our portfolio is a huge advantage. There's a heck of a lot of secret soft in our R&D that we're bringing forth in the form of methodologies and algorithms and patents that we hadn't done in the past. We can go end to end with a customer, and our global delivery implementation is a huge element for us. In the outsourcing deals, this is 78 to 82% of the cost structure.

We have to get this right. We've got the right leadership in place, and we're driving to much more standardization, speed and execution in this business. And, lastly, short term, we're going to keep the discipline focused on the metrics and on holding people accountable for achieving the profitability and the growth. Long term, all the investments we're making referred to here this morning will drive the foundation that we need for profitability, particularly of our managed services and our consulting and integration business as we go forward.

With that, I would like to turn it over to Todd to take us through the Personal Systems organization.

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

Thanks, Steve. That's great.

Well, I'd like to add my welcome and thank all of you for joining us this morning. We really appreciate your attendance. I'm going to take you through for about the next 25 minutes, obviously talk about the Personal Systems Group, give you some of our performance to date, talk about some of the strategies that we're putting in place to drive the business forward, and then some of our areas of focus for FY '06.

So, I think the best place to start is the consistency of the operating strategy, because our basic strategy will remain unchanged. This has guided our success to date, and it really remains the blueprint for future profitable growth. When we look around the four-point strategy, there are four kind of key pillars, key tenets, if you will.

First, we're committed to providing customers with an experience that's overall exceeding their expectations, driven through great service and great products. And some of he things that I'll talk about throughout the presentation today show you how we've really started to execute on that. Clearly, we're in a hypercompetitive marketplace and we'll drive world-class cost structures and processes to continue to drive profitable growth within the business.

I think you've heard everyone, Ann, Steve, I know VJ after this, talk about how we leverage the breadth of the HP portfolio, and I think it is kind of an untapped, great benefit that we all have to tap into and really differentiates us from any of our competitors. The fourth point is how we drive the broadest customer reach, how we optimize the channel balances that we're in, and like Mark, I'm not going to spend a lot of time talking about direct or indirect, but our focus is how do we provide great balance to our customers and allow them to do business with us where they want.

While this forms the blueprint for the overall operating strategy, I will you that you're going to see us emphasize three key areas. First, we'll continue to focus on improving our cost structure and improving our supply chain execution. We believe that there are a number of areas where we've made great strides over the past several years, but continue to improve, areas like consolidation of our operating infrastructure, consolidation of some more of our purchasing to really take advantage of our scale and drive cost out of our business, while at the same time accelerating the velocity of delivery of our products.

You'll also see us in this year focus more on demand generation marketing, very effective use of media to bring customers into HP. Talk to them about how we differentiate ourselves through both great products, great innovation and large presence to shop in. And then the last point is clearly how we optimize those channels, both from the perspective of the unique differentiator that allows customers that choice to interact with us where they want and how they want, but clearly optimizing the blend between the two to make sure that we drive the best margin possible in our business.

Just kind of a quick snapshot of performance, because we've had a very balanced view, very balanced performance of both profit and share during PSG's turnaround. And we continue to remain very, very focused on not just share for the sake of share, but how we profitably grow and take share. Now, a couple of things that clearly stand out in the most recent quarter, our notebook business grew by approximately 42%, kind of the power behind the overall PSG growth story.

And I think there are a couple of very key drivers to that performance. First is obviously our focus on mobility, both as a segment within Hewlett-Packard, and as a company overall. I think the broader ability for customers to connect in more places and in easier ways clearly is driving a demand for our notebook products. And, of course, we've seen the value equation become better, more powerful products, more compelling prices, and really a move into the consumer market. And we really see that consumer notebook market as one of the key drivers this year.

As far as in the overall balance, we've remained the number one provider in the world for consumer notebooks and desktops, and actually increased our lead over the number two player. And while we focused on both balancing share and profitability, it's still important to point out that we're twice the size of Lenovo, basically three times the size of Acer, and while we never

take or lose sight of what any competitor's doing, we'll still always remain focused, and I'll continually repeat the focus on balancing profitability and share. And over the past five quarters, as our share has steadily improved, our profitability has moved from, Q4 of '04, about 1.2% of revenue, to our most recent quarter, finishing at 2.8% of revenue, so very significant movement in improving the profitability equation for us. And, again, we're not planning to buy share at the expense of profitability, but grow growth simultaneously.

So the portfolio is in good shape. We've seen balanced contributions across our regions across the world, we've seen balanced contributions across our product categories, and clearly balanced contributions between consumer and commercial segments. So I thought I'd take a minute and just run through a couple of products quickly for you to kind of give you a sense of the blending that we have of both high-growth products, HP innovation and some of our unique abilities to get to market.

All of our products and all of the work we do is really centered around creating that superior user experience, be it the enterprise customer, focused on security and total cost of ownership, the SMB customer that may balance between shopping in a retail channel versus a commercial VAR, or the consumer that's at home, multichannel shopping between the Web and the store. So we've recently introduced the new iPAQ 6500, the converged voice and data device that we've begun selling with Cingular. It's a product that incorporates voice and data on a Windows Mobile platform, very easy, mobile-access applications, great access to voice and clearly one of the first converged devices out in the market.

From a workstation perspective, we've really raised the performance bar on the industry with our dual Opteron chip products, and HP Workstations are now supporting everything from Lance Armstrong's Tour de France-winning bike development to the latest movie from DreamWorks, extremely powerful products that bring that power of computing down to the desktop and down into the workplace.

In the consumer notebook arena, one of the kind of unique innovations that we've brought to bear is the suite of products called QuickPlay, and they're available across our Pavilion lineup, and they basically allow you to avoid that kind of long, tedious boot-up process if all you really want to do is listen to your music or watch a DVD. Our engineers have done some very good work on just how to get the maximum use out of the product for the customer.

And, obviously, we have spent a lot of time on our accessories and attaching those accessories to our products. And one just good example of a very simple, easy-to-use product is one of the adjustable stands that improves the usability, improves the ability to be a mobile worker and be effective at your desktop. Our Thin Client products, or Consolidated Client Infrastructure, is the fastest-growing category in our business PC segment. And it's right now the fastest-growing and most integral part of our Blade PC solution, and we'll talk a little bit about this more later, but Thin Client is all about reducing cost of ownership, increasing security, in the enterprise space.

And, last, then we'll talk some about Media Center, but our Media Center PCs now maintain number one share in what is the fastest-growing segment of the consumer desktop space. And while they bring the Microsoft Media Center advantage, we've looked at how do we innovate around that and bring an even better solution to market, and we've included things like ImageZone, which allows customers to better manage their pictures, allows consumers to get more out of that picture experience. LightScribe, that lets you personalize the disc that you may want to give a friend or family member through inscribing the disc right on the PC, and of course we've got screen technology that's made the viewing experience even better.

So our focus has really been, while driving cost out, how we prevent ourselves from being trapped in the complete commoditization of the PC market. Clearly, we're still very aggressive from a pricing standpoint, from a competitive pricing standpoint, but we've looked at what are the innovations that matter to customers and how can we bring these to market?

So, I've kind of laid out the product portfolio, clearly a position of strength for us, looking at innovation through the lens of the PC business and bringing innovation that matters to people is important. So let me talk a few minutes about the four big categories we play in and how we plan to build on our position of strength in FY '06.

So we take each category, first, in the desktop category. Obviously, it's not growing as fast from a category perspective as other pieces of our business, but we've really focused on how do we leverage both a huge base, a huge presence, and drive products like Media Center PC that are growing quickly and taking share. And is this the precursor for a suite of digital entertainment products that really bring the networked home to life.

From the commercial desktop space, I talked a little bit about CCI, and basically it's focused on both improving data security, data protection, and we've seen examples where it can drive total cost of ownership down by as much as 50%. So, clearly, a very interesting and innovative Blade architecture in the PC world that's been launched in about three countries and will be expanded as we go forward.

Our notebook business is extremely strong. We've got a very, very compelling product lineup that sits well against each one of the product segments that are in the market today, but as we move into FY '06, our focus is really how do we improve on that mobile solution? How do we make it easier to connect and easier to carry? So you'll see us introduce products this year that have integrated broadband, with partners like Verizon and other carriers. You'll see us look at form factors that are both slim and light, as well as larger and more powerful as we bring the Workstation capabilities down into the notebook arena.

And while we're talking about Workstations, our strength has clearly been centered around several key verticals, digital content creation, financial services, software development, oil and gas exploration. And while we've seen enormous strength in these categories, and we'll continue to work collaboratively with those customers to meet their computing needs, part of our challenge is, how do we expand? To Mark's earlier slide, how do we find the adjacent categories that provide us an opportunity to grow this segment? Excuse me.

From the handheld perspective, clearly iPAQ is a great brand with broad penetration. As we look at this category moving forward, clearly we're driving a transition from pen-based computing to wireless products, wireless products that we believe can meet each one of those core segments that we talked about, from the consumer to the small business, up to the enterprise user that wants to push applications down to a small, handheld device.

Obviously, we look at voice and data together on how we converge those into both a compelling form factor that provides enormous ease of use. I thought what I'd do next is let's take a look at the levers that we control within PSG on both our top and bottom line and how we'll continue to improve our performance.

So, as we look at the fundamentals and look in kind of a 2007 timeframe, our operating plans are for our revenue to grow 4 to 6%. That's basically on 10% unit growth, and we see this through a whole number of segments. Clearly, we see our notebooks continuing to grow faster than market. We see enormous strength coming from our emerging market categories, which we'll speak about later, and of course Workstations, as they continue to grow, drive a very significant margin and income opportunity for us. And one of the key tenets is really how we manage that margin mix.

We talked about operating margins. We're projecting a 3 to 4%, again, coming off a Q4 '05 performance of 2.8%, but we think that as we look at our portfolio, and how we manage that portfolio shifting back to more profitable products and more profitable regions, we have a very, very significant opportunity to achieve this plan. The other big piece, as we look at operating margins, it's how we continue to stay focused on our warranty performance. Our warranty cost has continued to decline on a quarter-over-quarter basis, and it's driven by several things. First, very clearly, improved product quality of our finished product is driving costs lower. Our ability to handle calls when they do happen in a more efficient way has driven that cost down.

And as we look at warranty from the perspective of the overall service experience, our real focus is at the time the engineer puts pen to paper, how do we design products that are easy to service, great to come out of the box and provide a very, very compelling solution, and there are some of the things that we'll continue to focus on, from both driving costs down and problems out of our business. From an SG&A investment standpoint, clearly, our plans are around how we drive growth in both our direct business, with additional salespeople, additional marketing resources, and of course, from the channel perspective, how we differentiate between those two buckets of partners that Mark spoke about? How do we work more closely with those that are

most aggressively selling a bundle of HP products and services, and maybe work in a more appropriate way with some of those that just want us to be a vessel for other people's products?

And I think it's fair to say that while we've driven lots of performance improvements within our business, we are getting some benefit from the corporate restructurings that the team is driving and we've talked about. Again, for FY '07, we're looking for a 50% improvement - or I shouldn't say looking for - we're planning on a 50% improvement in our return on assets. We think a lot of it will come from leveraging a very common IP infrastructure, both from the perspective of broadly taking advantage of HP's infrastructure, but also more tightly integrating with our manufacturing partners to drive inventory down and cycles up.

And we'll continue to look at how do we simplify our factories and logistics hubs networks. It's relatively broad. It's obviously broad in scope, but through both good pools and strong execution, we think we can consolidate those even further. And, of course, we'll continue to look at product design as a key weapon in how we take cost out. A great example this year is work that's been done in our Workstation business that's reduced the manufacturing time of our products by 60%, improved the serviceability significantly and reduced the cost of the product. So taking that design for manufacturing approach in our product development will be one of the things that over time will help us continue to improve our return on assets.

Now, you saw this slide a little bit earlier. Mark spoke about it first thing this morning, and I think it's very, very clear that the mobile space presents an enormous opportunity across HP's entire portfolio, from infrastructure solutions to services to software, and clearly to products that PSG products. Now, our participation in his growth market is significant, and it's significant at the device level, because right now, more than 40% of PSG's income comes from notebooks and handheld products.

And we've continued to see strength broadly across our segments, from consumer to commercial, the strength of the product and the compelling nature of the solution has continued to drive our share up in that category. In addition, as we look forward, really the convergence of voice and data that's beginning is going to provide a broad set of solutions, a broad set of solutions across the desktop space, as well as the handheld space and the notebook space. And when you think about voice over IP and product designs, it can really transform that desktop space from really being strictly a computing platform into one that's a more secure, connected communications environment that has very, very broad implications for us, broad implications from simplifying a service experience to increasing the usability and the real need for an HP desktop.

Now, let me take a look at - let's just take a look for a moment at some of our momentum in the mobility space. Clearly, you can see from these charts the success that we've had to date. It comes from the breadth of our portfolio, it comes from the fact that we have probably the most compelling product lineup in the industry today, and as we look at next year, we'll improve this product lineup with seven new products in the first half of '06, products that span the capabilities of offering, wi-fi, broadband and ultra-portable products.

We'll continue to improve the customer experience through some of the innovations I've talked about, like QuickPlay, and like how we enable you to protect those precious data assets that are important. And, of course, we've talked a lot about enabling customers to buy, where they choose and how they choose. And retail, our retail channel, is I think one of our best-kept secrets. The strength of our people, the strength of our channel relationships, have clearly helped us build this commercial notebook business.

And while we've talked about multichannel strategies, I think we should also just take a minute and talk about the emerging markets, because as we talk about these, they're really not emerging for us anymore. We have the ability to build on a very solid HP foundation not an emerging market, but now what I think are high-growth markets.

In China, we're growing four times the market rate right now, we're reaching more than 200 cities with more than 1,000 partners. In India, we added 4.6 percentage points to our marketplace that's already growing at 30%. And as we look at our multichannel approach in these markets, second and third-tier cities, clearly, it enables us to build a very strong base with service partners that understand those local customer solutions and help us drive a product that meets those needs.

So the net-net is really we're not in an expansion mode, per se. These are solid businesses that we're now looking at how do we grow at very, very aggressive rates. And in any market, sustainable advantage starts with satisfying customers, so I thought we'd just take a quick look at some of the things that we've done to continue to improve that experience. By delivering experience that works for our customers, clearly we improve our overall performance.

Most recently, through lots of things, through technical solutions like Total Care, and Online PC Tune-Up, we've received the JD Power & Associates Certified Technology Service Award as providing the best service in the United States. And I think it's very fair to say that these improvements in service have really been reflected in our gross margin performance and been key supports to how we continue to improve our financial performance.

So I'll wrap up with a couple of key points, and I think it's important to, again, lever off of one of Mark's points earlier today, and that's that PSG controls the levers that will lead to our success. We're very well positioned in growth segments such as mobility, and such as the high-growth emerging markets. Our competitive advantage really comes from our ability to be both a multichannel provider, a multi-technology provider with a great balance of Intel and AMD products, really focused on what does the customer need?

Obviously, we're looking at how we run the invention and innovation that we can generate through HP Labs through a PSG filter that looks about what's important to customers, what matters to customers, and how do we do this in an affordable way. And it goes without saying that I'm extremely proud of the customer service trends that we've started to produce, not just from the perspective of performance overall, but really pulling that customer experience, bringing that customer experience, to life.

And I think it's very clear that we've made the shift. We've taken control of levers that drive our business, we've generated great products, great service, and we are very well positioned to perform in '06 and beyond. So with that, I'd like to thank you for your time and your attention, and now pleased to welcome VJ, who will speak about our printing and imaging business.

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

Thanks Todd.

Unidentified Corporate Representative

Thanks, VJ.

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

Thank you, Todd. So what I want to do today is to talk about imaging and printing. I think the key message that I want to leave you all is this is a solid business, which we can continue to grow between 4 and 6%, and have operating profit margin between 13 and 15%. Now, when you look at IPG progress support, I think the first key thing that we want to talk about is in year 2004, our units were declining, especially on the inkjet side, and we talked about this that year 2005 we wanted to do three key things. The first one is we want to get our cost structure right. We must make sure that we get the capacity and capability with which we can invest in the business, and go after unit growth which will drive our annuity stream (ph).

The second thing we wanted to do was to really make sure that we invest in the business. It's not just about growing our core business, but finding the right opportunity for us on emerging in the new businesses so that we can continue to enjoy the growth that we have for IPG with 13 to 15% operating profit. The third important part is really make sure that the opportunity we have within HP portfolio Steve talked about, managed print services. Steve and I are working together in finding the right focus for organization, in his organization, to make sure that we can go after this managed print service opportunity very profitably.

So those are the three key things. So when you look at our progress report, you know, look at our market share we always enjoyed with leadership market share. For the last 21 years I know, we get the second competitors always different, sometimes Canon, sometimes Epson, some not. They are always in that line that, you know, you see lay down, hopefully, continue to lay down, and the main thing for us is to enjoy the scale and drive profitability that we enjoy with IPG.

If you look at our unit growth, this is ID's (ph) data in the third calendar quarter, 11% overall. 19% for the laser, 9% for the inkjet, and for last three quarters, we have consistently going after the unit market share I talked about. If you look at the overall market share, it has gone up 1.6% in second-quarter calendar Q2 to the third calendar quarter. Very important message. Now, when you look at -- this is a unit market share. When you think about the value market share, ASP point of view, HP always enjoyed $50 difference between other competitors, and the value market share is even -- you know, the distance is even higher when you look at that.

Now, let me talk about specific product categories because you want to really understand what's the mix and what's the balance that we want to achieve. When you look at our mono laser market, which is very important market for us, especially in emerging markets, where the growth is still there and we want to enjoy that growth, we increased our market share about 1.6%. Color laser, I have talked about color laser opportunities. Because color laser market is going to be doubling in next 40 years, our market share went up by 2.7%.

The inkjet, single function inkjet, our market share went up by three points. In all in one, our market share was flat. You know, there is a good market share, and there is not so good market share. You know, when you giveaway is all in ones, we know that a lot of them are not even opened. You know, we did a very interesting market research. We said, you know, we will do some training programs, and try to find out what's really happening. What we found that some of our competitors we're giving away those printers when they were 60% of them that we got back when they were opened.

Now, when you put this installed base and nobody uses it, really bad things happen. That's very important thing to understand. So in every single category, either we maintain or we get market share as we move forward. From IPG of the viewpoint of view, in year 2001, we go all the way back, we were declining business, we were making 10% operating profit. With the right structure, with the right innovation, we have got this business growing, sometimes 10%, sometimes 4%, but you know, really you know 4 to 6% I'm very comfortable that we can continue to grow this business and move our profitability from 10% to 13 to 15%.

Actually, in 2003, 2004, we got a lot of profit out of that. We had to really get that right balance in terms of what we wanted to do with profitability and market share, right market share. I think that's the key. We absolutely believe that if you can build the right portfolio of all the businesses that we want to go after, there's a tremendous opportunity . So let's talk about the way we think about growth . Now, as Mark mentioned, you know, there's a lot of perceptions that we are consumer print the company. As a matter of fact, I've been consistently saying that we need to think about pages, and not about printer hardware, not -- we are all about printing, and not printers. I think this is a very important message.

Now, when we think about printing, and think about all the pages that we can go after, the trillions of pages that we can go after, you know, we can look at these things and look at our core competencies, and figure out you know where and how we can find the growth. Now, the top side, you know, we talked about all the customer segments; consumer, small and medium business customers, enterprise customers, to the graphics customers. The one key thing you can see in our 6 growth strategies I've laid out, you know, there are more opportunities now on the commercial side, and business side of the boat than the consumer side still. Digital photography is a very important opportunity.

This is where we are going to continue to drive all the touch points. We want to get all the customers capturing, creating, and sharing their memories, irrespective they are in the home, they could use online and then get those pictures from the retailer, today, we've talked about that position that Mark talked about, the (inaudible) starting point. We went from 14 million customers to 20 million. Now, with the position that we have done in Europe, we can get our footprint bigger and go after this globally.

We also have intentions to go after retail photofinishing. We fundamentally believe that we have technology and solutions with which we are going to go across all the touch points. The call businesses must grow faster than the market, go after the digital photo business. Now, the businesses that I'm going to talk about are in the commercial segment. The first one is the capturing copier pages. You know, copier is a $24 billion market, and if you think about just copier market, it's actually flat to declining, but that's not the way we think about it.

The way we think about it is how do we really get our great LaserJet product line, the reliability, quality, and putting copying functionality and capture those pages? If we can do that effectively with a business model that we have, then we are going to do this very profitably. As a matter of fact, after our introduction of 4345 multifunction printer, in (inaudible) segment we have gone from kind of 1% market share to 16% market share, just in one year. Now we are introducing a color version, (inaudible) lineup and go after those copier pages aggressively.

The copier pages also allow us to now build a complete portfolio, so I can partner with Steve, and go after the managed printing opportunity. We can tell our customers and enterprise customers, saying look (ph) just like server consolidation, storage consolidation, we can help you in making this managed print services a very good thing in reducing the cost and improving the productivity.

We also believe that there is, again, think about all the pages, the marketing collateral world. We believe that we can change that both from in-house printing, with our color laser where people want to just do it very simple thing (ph) to really work with our print service providers with our Indigo technology, where we can get offset (ph) quality with respect to the marketing collateral. Both are very big opportunities.

When we think about industrial printing, packaging, label printing, printing signage, this is where the analog to digital translation will create a tremendous opportunity, and HP is the only company who has all technologies and solutions with which we can go after that very aggressively.

All these five growth opportunities will drive our supply business, and that's the beauty of this business model. You know, we put all these pockets and then enjoy the annuity stream for a very long time very profitably, really understanding this customer installed base and helping them to meet their needs, make sure of the needs, especially take care of the loyal customer is very important. This is the reason that Mark and Randy are doing (inaudible) data warehouse is very important because we want to get this customer information, mine that information, and drive the aftermarket growth. Very important strategy.

We also believe that in imaging and printing we have core intellectual property, 9000 patents that we absolutely believe can go and use that core competency to go after new businesses and new business models, like (inaudible) is one example. Yesterday, we launched our halo collaborating room (ph). This is where we are going to change how business are going to really not (inaudible) and have the same experience that you can have for a face-to-face meeting with using the technology. Because of our understanding of color science, understanding of our networking, understanding how we can deliver solutions, we are going to change that.

So these growth strategies are going to allow us to continue to grow our core revenue, and maintain the profitability. A lot of competitors I showed in the first slide, they are only in the first part, and people talk about that, and we believe we grow faster than the market, that really invest and go after those growth opportunities. Let me talk a little bit in-depth about this growth. First thing is, again, you are going to always see us now talk about pages. That's how we want to describe the market. Our addressable market in 2002 was only 4%. Now, with our newer capabilities, our addressable market has gone up to 11 to 12%. By 2010, 17%.

The page growth is 5%, and these are all high-value pages. So not only we will get our revenue stream and profit stream from ink cart toner (ph), but actually media will become very important part of our profit growth. Same growth potential that I showed you earlier is shown now in terms of the pages. So you could map how the pages are going to grow, and then how we are going to allow you know our technology and out solutions and our go to market models, to help us in growing this business.

Now, for a very successful business, it's very important to have the right portfolio because certain businesses like our monochrome laser business, our single function inkjet businesses, you know, these guys are going to be really providing tremendous profitability for us, but the revenue growth potential is limited. This is where we need to make sure we look at our cost structure, we look at our development models, we look at our supply chain, because essentially these are commodities, and here what we want to do is to really maximize our profitability to make sure that we are taking every single cent out of the cost of goods sold, and our op ex structure because we absolutely believe that we have the leadership, but we need to drive this still aggressively, as a core business.

At the same time, without tremendous emerging businesses, colored LaserJet, the digital photo business, going after the multifunction printer, we want to invest there, not only from technology point of view, but go to market point of view, because as Mark talked about, really addressing the coverage model, really making sure that we can touch these customers and having the conversation with them in terms of the opportunity we have.

It's also very important that there are certain fundamental trends and discontinues happening in the market, and how could we use our assets that we have so that we can go after the new opportunities? Emerging opportunities are the new opportunity. So you could see that we are doing three or four things in parallel and that's the very important part. The first thing is, we will improve our cost structure because if we don't improve our cost structure, we are not going to really get the opportunity that we have and we cannot explore that.

The second thing we need to do is to make sure that we understand each asset that we could use right now, leverage the portfolio, change the market, and drive the opportunity. The third thing we want to do is at the same time build some new stuff so that we will be able to continue to grow. You know, Snapfish was a great example of the strategic content that we had and finding a completely new opportunity in photo services business. We think that if we build this core emerging new portfolio game, very aggressively, at the same time grow our top line and bottom line, this business is a phenomenal business to drive 4 to 6% growth at 13 to 15% operating cost.

So I talked about our technology portfolio, and as I said, there is not a single company in the world having that kind of a portfolio. We talk about our (inaudible) inkjet, and not only we have these proprietary technologies, but we have taken it to the next level. Scalable printing technology was the example when we introduced in July. The last 40 years we have been developing, investing billion dollars in making that scalable printing technology work for us.

Now, if you are a company say, oh wow, that's a good idea, let's get up in the morning and say, hey, I want to do this thing, too late. Okay? You should have thought about that 40 years ago, and build this technology to really make sure that you could drive you know the opportunity that we are talking about. Drive electronic (ph) photographic technology for lasers, very important technology. We are the leaders in LaserJet for the last 21 years. DesignJet, we build this business. We are the leaders in technical market, we enjoy 70% market share in this business.

Now, what we are doing is taking that business and leveraging it into the graphics market. We only 30% market share. That's a good thing. You know, we have opportunity to get to this 50/60% market share because we are the leader, we understand the customer, and we can drive the same market share that we enjoyed in the technical market. Indigo, we acquired this very different technology.

It's the liquid electro photographic technology. Indigo is the only technology with which you could get offset quality. Remember I talked about this, trillions of pages, only way you could get the same quality that you get on a high-level press (ph) you have to use Indigo, and that will really drive fundamental sustainable competitive advantage that we could enjoy long-term.

We felt that we couldn't go really after the signage market with either thermal inkjet, or liquid EP. We felt that there was a gap. Again, we acquired Cytex, they have these electric (ph) technology, they are the leaders in signage market. Now we have this portfolio, we have hundreds of chemists who understand ink technology. We will take that knowledge and apply it to Cytex.

We will take that knowledge, apply it to Indigo. This is what is going to really get the worker (ph) cycle going, because we understand the technology, we understand the customers.

Now, the important part here is that, as Mark said, now we need to build up our go to market models, make sure that we align our opportunities end to end from technology to the go to market models. If we do that, that's the investment we are making, get the cost structure out, invest in to go to market models, we know we can convert this thing into profitable growth opportunity for us. So scalable technology. I think, as I said, this is a sustainable competitive advantage.

We use photolithographic technology here (inaudible) everything is using very accurate, very clearly, an asset. You know, when Bob and Mark talked about our capital expenditure, that's what we need to expand on. We need to make sure that we continue to drive our technology at a high-level. I think to really show you what I mean by this printing technology, let's roll the video on scalable printing technology. (Video Begins)

Innovation is at the core of what we do and Hewlett-Packard art and the core of what we do in our R&D labs. HP has a tremendous commitment to R&D. Scalable printing technology is really HP's new entry into the market. It's a whole new thermal inkjet technology (inaudible) developed from the silicone on up. Scalable printing technology put all of the printhead technology onto the printhead itself. There's 3900 nozzles on a printhead. 3900 nozzles printing and blazing away to give that customer speed and quality.

We make the entire printhead in our silicone wafer fab. The benefits of scalable printing technology are speed and image quality. They are four times faster than our previous technology, about 14 seconds for a 4 by 6 photo. It's also extremely reliable, and that's enabled us to be able to make the ink cartridges separate and put them upfront, so the customers can get to them. You are not only getting printers, you are getting complete set of inks which are redesigned to work with our printers, you're getting special media.

When you bring it altogether, new media, the printers, the new inks, what you have our digital images that our fabulous, they are good-looking, they have the right colors, they are fade resistant, and they are fast. We can use this product starting with the low end users all the way up to our higher and more sophisticated users in home. Likewise, we can scale this into other market areas like business inkjet printing or commercial or photo professional printers as well.

(Inaudible) can be great for business. It can provide faster output at lower cost than previous applications. Behind HP's commitment to innovation, it's the customer. It's about enabling the customer to have some fun, to be creative, to be able to do things that in the past was never within their realm, and now we are making it easier, faster, and higher quality than they could have ever dreamed of. When you see the results and what you've been working on, and you see where (ph) the customer stands, and they go, wow, this came out of my inkjet printer? That really is the best part. We continue to advance and innovate on behalf of our customers. That's what we do. (Video Ends)

So you know, when we look at digital photo opportunity, it's a 19% (inaudible) pages is going to happen, and when we will have a technology that we talked about here, it can print fast, we went from 40 seconds to 14 seconds, we went from $0.60 per photo to $0.24 per photo. Nobody can really do that because, as I said, you need to start that 40 years ago. And in the video we talked about, and you could see a little bit there, that we are going to take the technology into photofinishing realm, because we know that customers not only going to print in the home, which is 67% of the people do that right now, but online and online to retail is going to be very important for us.

So when you look at the way we think about this, is every opportunity we have with a customer to capture create and share, we want to be part of that. Snapfish, as I said, was a very important acquisition to raise announcement of (ph) (inaudible), which is very important to get into Europe. We are going to be in 11 countries, very important acquisitions. Fundamentally, we believe this will give us a footprint that we absolutely believe is going to drive our photo growth, and then stay tuned. This year, we will talk about our retail photofinishing.

Color in the office, IDC information, next 4 years from 2005 to 2009, it's going to double, it's going to become from 11% of the overall laser to 22%. Now, the beauty of this is also the toner consumption. Color LaserJets consume four times more toner than a mono. So when you think about this 22%, the overall toner, color as a percent, is much much higher because of the phenomena that I talked about. At HP, we don't need company to tell the real price performance that we talked about. People talk about performance.

The real performance means the first page out, because that's the productivity. If your three page document -- you know, our document will be done while the competitor is still warming up. That's the difference that when you buy you know HP. The color sphere (ph) is the way we are really branding our supplies, because we fundamentally believe that supplies market share is very important for us. We don't tell the story. You know, when you buy colors sphere, you get the reliability and quality. If you buy resale or refilled cartridges, you are not going to get that. That's very important for us. Just take Rivera and the way we are going to talk about our inkjet supply, color sphere is the way we are going to talk about color laser supplies.

High-end opportunity is very big. When we think about the market, we think about you know from commercial printing to graphics, on one axis, that's what we call application, and then print volume because you know you want to really match, depending on the customer's needs, the speed and the technology, that multifunction printer market is a copier market, $24 billion market, coming from LaserJets up. Indigo, this is the high-end of the market. The market (inaudible) and the Cytex is going after the signage market. Very big opportunities.

The one in the middle is very interesting. What we are doing is we know in certain markets we don't want to have our branded products. We take our inject technology and OEM that for mail printing, for point-of-sale printing, for label printing, because there are a lot of printer vendors they have a lot of resources to take our inkjet technology and then drive you know that market. So we don't have to really worry about it. Their annuity streams is what we are interested in, and that's what we get for that kind of a model.

So copier market, $24 billion market. We went, as you can see, the blue chart, I love that chart, from nothing to 16% market share. Now, it's not about just getting the market share, we are absolutely structurally changing the market. The copier market is all about high-end, $10,000 product with a limited distribution. You have to go through the copier channel, but we are saying distribution is open. If you sell LaserJets you could buy the product. We also have got the price point of a multifunction printer one-third; 2599 for a monochrome 45 copy per minute you know copier printer.

I've been distribution. Because it's from LaserJets, reliability, connectivity, that we can actually say if you know how to install a LaserJet, you could install multifunction printer. Because of our universal driver strategy, you don't have to worry about really understanding and installing driver because the driver because the driver that you've got works for all your imaging and printing. And that's really the power that we have.

We have Web JetAdmin, where IT manager can manage all the devices, including our competitor devices, because you know market share in Web JetAdmin is like 80%, we are number one hardware market share because our competitors are making sure -- because IT managers demanding you'd better get Web JetAdmin because otherwise we don't know how to manage, because from your desktop you want to manage you know these products.

We have universal driver, same driver, works all the time for all, so from productivity point of view, you don't have to learn new user interface. You know, once you know one driver, you know all of them. Clear competitive advantage for us. So the services point of view, the work that we are doing with Steve's team, the scalable offering, flexible financing, and overall, the portfolio that we have for HP services really help us. Let me give you an example. For PM (ph) we help them to reduce 25% cost and the thing that I really learned from skeptical to thanks because it's a change management.

People want to say, don't come between myself and my printer, and that's our printer, right? And the way we help them is say, look, we do have better productivity, you are going to better technology, you are going to reduce the cost and we convert

people from skeptical to they say thank you, thank you for doing this. PM is a great example of how we can go to enterprise customer, help them to improve their productivity, reduce the cost, and really manage their printing environment.

Graphics market, big opportunity, from large format to indigo, $10 billion market growing rapidly. We absolutely believe that we should be enjoying higher market share here if we focus on it. If we focus on commercial printers, if we focus on labeling and industrial printing, we focus on signage, we should be able to with the right go to market model, enjoy the growth that we absolutely deserves because our customers are telling us you know help us, help them solve these problems we can continue to grow these businesses.

Supply, very important part. We absolutely must make sure we continue to innovate, continue to tell the story, why HP, we continue to message it, because it's very important for us to continue to drive our profitability and revenue growth here. As use all, once you get the unit growth going, supplies will -- is going to follow, very important part of the business model. We also are (inaudible) strategy in last few years 200 million pounds of inkjet cartridge and LaserJet cartridges we have you know recycled. Very important part of the strategy. We allow our customers, if they want to recycle, it's a very simple thing, we send them a reach them to envelope, they could send back very important part the HP, from serving the community very important part of our strategy.

Also, we are going to protect our intellectual property. Any partner or any company which will really break the rules, we are going to go after them, we will consistently run that every year. This is very important part of our strategy. All our innovation, all our R&D we are spending, we are going to make sure we protect them.

We are continuing to test our stuff against our competitors. Very interesting data; 80% of (inaudible) refill cartridge will file, but ours will fail 2% for the life of the printer. Third party people are testing these things, a lot of volume to get that statistical data that I'm talking about. Inkjet, 70% of refill or inkjet cartridges will fail, and ours are only 2%, and nobody wants to get all this stuff, information critical, and you run out, that's not a good thing.

That's not a good thing, and I think this is what we continue to drive making sure we use our innovation, and drive quality and reliability. Photo quality, very important. As you can see, in test after test, these always test better than (inaudible), better than our competitors. Opportunity from growth. You know, 24% growth for color pages, 19% growth for photo pages, marketing (inaudible) doing in-house, 384 billion pages are only two to three pages that small and medium businesses could do that in-house period multifunction printing, all these things are going to allow us to continue to grow.

Growth strategies are solid. We absolutely have operationalized this thing. We are aligning our go to market model, we are very confident that we can grow our business 4 to 6%, maintain 13 to 15% profit. We get this momentum that we started in 2005, continued leadership and innovation. I'm going to stop here, I'm going to invite Ann, Todd, and Steve, and they are going to take questions.

QUESTIONS AND ANSWERS

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Okay, it's Toni Sacconaghi, from Sanford Bernstein. I have a couple questions for VJ please. You talked about your core business, and really the imperative to maximize profitability there, but ultimately the biggest constraint on profitability in your core business is the fact that you don't earn your own laser IP (ph) and that you share profitability with Canon.

How sacrosanct is the Canon relationship going forward? And if it really is a profitability game in the core business, and color laser is so important, what are your degrees of freedom for seeking liberty from that arrangement or developing your own technology? And I have one follow-up.

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

So I think that, you know, first all, we have relationship with Canon for 21 years. I want to make sure that you all understand, this is a very (inaudible) relationship we have, and we are growing the market together. And we are enjoying tremendous profitability plus (audio break) economic asset point of view, there is no other business in the world. I would just like to make sure that you understand that.

So our relationship is very strong. We fundamentally believe that the growth opportunity I talked about from color laser (inaudible) to multifunction printers side, we absolutely believe in Canon. I think we have the best partner and we will continue to grow/drive profitability with Canon.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

So, just to finish that, is that relationship binding with Canon and is there - can either party, with some degree of forward warning, change that relationship? So, if we're here in three years and it's different, are you telling me there's no possibility of that happening?

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

There's no reason. It's a win-win, Tony. I think what we believe is we continue to see is a tremendous win-win and opportunity. And a very important part you don't understand from an imaging and printing point of view, the installed base rise (inaudible) profitability. I think that's a very important part, and I think about a relationship is really long-term and I don't see any reason to change that.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

And then, just on the growth initiative, if you were to say, you mentioned several - digital photo outside the home, Indigo, Cytex, the graphics market -- I mean, which of these is the first to likely become a $2 billion going forward? I mean, yes, they're all great opportunities, but they're all relatively small - hundreds of millions of dollar businesses. So, which of these three or four can be a $2 billion and in what timeframe?

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

So, I think, first of all, we're not going to break out financials, okay? But second thing is we fundamentally believe that you can't have a hockey stick. You really want to really build a clear portfolio with which you can continue to grow your business. And it's all about a lot of singles rather than just always homeruns. That's what we fundamentally believe. So, think about, in 2002, I talked about getting the low end and then going up with the (inaudible) and then going up with the copier market. Now, you should think forward. I really believe digital photo is still a very big opportunity because that transition is going on very big.

Color, laser, very big opportunity because we fundamentally believe that market is right for a lot of growth. The third growth opportunity might be function printers. We fundamentally believe that we have absolutely changed, structurally, that market, so even the market will not be growing, our growth is tremendous. You go from zero to 15% market share. We just introduced a color version of it. A lot of opportunities for growth in coming years.

And then, we will talk about what we can find on the marketing collateral, both in-house and using the digital publishing with Indigo. Then Cytex. So, you just - the way we think about it is where you're going to build the stack in terms of the growth opportunities. So, no single ones, but we fundamentally believe combination of all that will allow us to grow 4-6% in revenue and maintain profit of 13-15%.

Brian Alexander - *Raymond James - Analyst*

Also, a question for VJ. Brian Alexander with Raymond James. On the copier market opportunity, you talk about a $24 billion market. Is that the entire copier market is there a way to break that down to segment two through segment four?

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

For the market, we will go up is S2 segment to S4 segment because that's where we absolutely believe is our opportunity is. And the process we are taking is this is a current market -- the $24 billion market is current market. The approach we are taking is structurally changing that market. Because most of the opportunity there in copiers right now is one-third hardware, one-third supplies and one-third services. But if suddenly we really break and fix services.

What we believe, I think our business model should be really hardware and supplies and a little bit services. I think that's the approach we are taking. We're coming from a laser jet approach and actually changing that market structurally because we are having one-third the price point. So, I believe that the opportunity that we going up is S2 to S4, $24 billion market.

Brian Alexander - *Raymond James - Analyst*

And then, just a follow-up. Where are you seeing early success with the 4345 in terms of customer segment? Are you seeing more success in SMB or more in enterprise and how should we be thinking about those views (ph) that are being incremental versus cannibalizing existing laser disks?

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

I think it's a balance, first of all - half of it is coming from enterprise and half is coming from small and medium business. Half from - a lot of business we are getting from the channel. And it's different by region, so Europe is very different than North America. But really, what we are saying is we are actually getting (inaudible) from copiers. Because at $25.99 (ph) for a monochrome multifunction printer versus most of the monochrome lasers are like $600, on average. If people are going to straight up and spend that kind of money to buy this thing. Most of the printings (ph) are coming from the copier side.

Shannon Clark - - *Analyst*

VJ, it's Shannon Clark (ph). Hi.

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

Hi.

Shannon Clark - - *Analyst*

I guess it's the VJ show today. A couple of questions. One on acquisitions. You've made a few this year. Do you see other areas that you need to acquire?

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

Well, I think, we are going to be open for really understanding the gaps we have. And we're always open. I think what we are going to see as the strategy we have, we absolutely believe today we have the capability in HP, with the acquisitions that we have done, to go after the growth. So, we will always evaluate.

Shannon Clark - - *Analyst*

Okay. And then, the other question is on competition. Specifically, can you talk about anything you're seeing out of Kodak with regard to the Incheck (ph) technology? And then also, any changes you've seen in Dell's strategy with regard to printers.

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

Well, I think, when you look at Dell and I've been very consistently saying for the last three years is it's different. This business model is different than PCs, where you don't have the equivalent of Microsoft and Intel. So, they go work with a lot of vendors and what we are seeing, actually, if you look at the IDC data, the market share, combined between Lexmark and Dell, has gone down by 33 points versus the highest market share they have. That tells you. And what I'm hearing - and actually, I heard it last week, that they don't make money. So, it's kind of interesting. We feel that it's easy to make money when you are a billion dollar business.

Ben Reitzes - *UBS - Analyst*

VJ, Ben Reitzes, UBS.

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

Hey, Ben.

Ben Reitzes - *UBS - Analyst*

I'm going to stick with the trend.

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

Okay.

Ben Reitzes - *UBS - Analyst*

I'm going to try to toss you a softball here. There's a negative thesis, I think, in part, due to one of your competitors. Lexmark had a very tough year. And why aren't you Lexmark? Explain to us - just give us a quick summary.

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

Okay. All right.

Ben Reitzes - *UBS - Analyst*

I mean, I - and then the follow-up is Canon. On the Canon front, I hear they're cutting a lot of costs. Aren't you going to get that?

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

Okay. All right. Let's talk about - again, I want to talk more about customer than competitors, but okay. I just want to make sure that I say that up front. I think the first thing is when you partner and really partner with somebody who doesn't have the technology and try to go up with the same profit (ph), especially in the lowering of the market, that's shipping vanity (ph). So, I think that's the first thing that I would say. The second thing that I would say is when you don't innovate, they're technology, they're not (inaudible) from 99. And you continue to just repackage. Customers really look for solving their problems and I think that's a second issue.

I think the third issue is fundamentally when you have more multiple technologies, you are developing. Developing ink and developing lasers - you really look at your R&D dollars and how you're going to focus them. The fourth thing is when you work with a partner who only wants you to do that, you're going to really upset the channel. And that is going to play. So, this is not just one thing, but multiple things.

And that's why the HP approach with innovation, understanding the customer and really driving the business. And we use a good scale (ph) to get a very tight cost structure. And we are not afraid. If you see that our cost structure is not aligned, we won't take the action. So, I think those are the advantage.

Unidentified Audience Member

(inaudible) from Citigroup. I'm going to put the VJ show on pause for one second. So, for Ann, a quick question. Ann, can you talk about how you manage sales force compensation during the transition from PA risk and alpha-based servers to Itanium-based servers, given that the margins are substantially lower? And if it seems like it's going to become more of an issue over time, given the shift is arguably going to pick up steam here over the next year or two and how do you do that without angering your sales force?

Ann Livermore - *Hewlett-Packard - EVP, Technology Systems Group*

There are a couple of things that are really critical to the question that you're asking. The first one is that our sales force does, as you would anticipate, have compensation metrics that reflect those revenue and margins like most sales organizations do. And part of what we do whenever we're trying to push a new product category like Integrity, where the gross margin is lower than on PA risk, is you use the management in addition to the compensation system to make it happen.

We've got a lot of sales district managers, sales managers in every country in the world and they know that Integrity is critical to the future of our whole computing business. So, they have incentives based on it being part of their job, just to get that done. There's a lot of focus in our sales organization with the installed base around PA risk. So, we'll certainly sell those PA risk solutions as well as our integrity solutions as they go forward. And we feel comfortable that we've got the right focus on both those things.

Unidentified Audience Member

And then, a quick follow-up for Todd. Todd, you've done a great job in the PC business of revamping the backend of the supply chain. Could you talk about - or maybe rank the top three or four opportunities as you see them to improve the supply chain from here? There's been talk about distribution consolidation in Europe taking more business direct in certain segments and geographies, but what are the top three or four opportunities there? Thanks.

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

There is - I think there are a couple things. I think, first, clearly the consolidation of some of our logistics helps is a big opportunity. We're taking a hard look broadly at platforms to see if we had some consolidation opportunities there as well. I think the third piece is more aggressive utilization of some of the IT pools that we're going to put in place. So, there's always a technology component that really helps you aggressively manage inventory and increase turns.

Laura Conigliaro - *Goldman Sachs - Analyst*

Laura Conigliaro. Back to you, VJ. Sorry. You talk, of course, about the relationship that you've had with Canon for 21 years, but yet, it really looks like your self interests, both companies, at least gradually, is starting to diverge. Perhaps, on your part, with the SPT and copier strategy, both in the position to at least partially hit Canon business, their core business, in fact.

So, what is it about the contractual arrangement that you have that really keeps it as tightly together as it has been? Or is it really more that you're counting on the 21 years not being something that will part the two companies? And then, one more thing. Also, on the remand side, would you expect or why wouldn't you expect remand to increase now that you've separated the ink heads from printer heads, similar to what Canon and Epson have seen?

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

To your three questions. I want to make sure I answer all three questions. The first question, let's talk about the Canon. I think the copier market - we are using Canon technology to go after the copier market. When we talk about 4345, 4730, that's a Canon technology. And I think, from the business model point of view, it a really win-win for both of us. Otherwise, you can go to this aggressively thing. So, this is not about just a relationship, but it is a business that we both believe, fundamentally, that it's a great win-win for us. So, that's the answer to the first question.

The scalable printing technology - our approach is we are really going after the market where we believe scalable printing technology is important. When we think about the business side, it's in the micro business that we are going after because laser has tremendous capability in terms of the beauty cycle, in terms of what we want to do with that technology. Plus, we believe that going after recent (ph) photo finishing and commercial markets, that's where ink head can shine. So, ink head has another advantage in getting the great quality at a low cost structure. So, I think what we want to do is right - find the right markets that we can apply the whole technology.

And we (inaudible) is that at the end of the day, customers should have a choice. Customers should have a choice and we have all the technology. Answering on the (inaudible) and remand side, we believe that the innovation is extremely important. That other parties really segment the market. So, when you think about our portfolio for supplies, we have supplies which are focused on purchase price to the consumer, especially in the home.

And we really look at the purchase price of the cartridge. And that's why we have $14.99 color cartridge because the cost are competently (ph) higher, but we are really looking at the purchase price. When you go off to these high user applications, there the cost of ownership is very important. And so, we have scalable printing technology, which really focuses on the cost of ownership rather than the purchase price. And I think that's the approach that we're going to take to really address, by customer segment, the supply channel.

Andrew Neff - *Bear Stearns - Analyst*

Andrew Neff with Bear Stearns. A couple questions for both VJ and Todd. One, just overall, why doesn't - what are you doing to provide a more effective marketing message. Apple clearly is perceived as a much cooler brand. You dominate the printer

market. What can you do to make printing or even, Todd, you have some features that others don't know about. Why don't you tell the message more effectively.

Two other questions. One is why do you still have a Compaq and HP brand? Isn't that - what do they mean? What are you doing to address that? And third, do you have a strategy for music?

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

I'm sorry, what the third one?

Andrew Neff - *Bear Stearns - Analyst*

A strategy for music.

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

Okay. So, the first question - I'll start about demand. Maybe VJ can tag onto that. As we've created these three large business units, we've taken much more hands-on control of a direct marketing message. And you'll see, as I said in my comments, BSG specifically take a much more aggressive demand generation message. Now, as far as the brand difference between us and Apple, the HP brand is very much the trusted friend - the trusted guide to technology. So, differently positioned than Apple, a little more share than Apple. But clearly, differently positioned. But you will see us, Andy, to your point, we've brought people into the company and we're starting to rev up that demand generation engine.

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

I think the approach you will see us and Cathy Lyons (ph) and I talked about it. We are focusing more on the brand at HP level. We want to talk about our products and the scale stuff as Mark already said. So, what we want to do is to really talk about why and what unique value proposition we have with our HP products and tell that story very effectively all the way from the media to on the aisle. Because we fundamentally believe that we want to tell that story by product category and say why HP and what's the unique value proposition. So, that's a plus shift that you're going to see us very aggressively talking about that.

The second thing is we fundamentally believe that radically simple better together message that when BSG and IPG is very important. That's what customers expect. When they HP, a PC or a printer, they want to make sure that all these drivers come loaded. They can just start the computer up right away. I think those are the two key things that we are going to change and we're going to shift and making sure that that message is very clear to the customers.

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

Yes, so VJ's point - he's absolutely right. Right? We've got a very strong brand halo that's out there and you'll see much more tactical demand generating message. As far as, Andy, your question about Compaq and HP, we've done and are completing a lot of work to understand what those two brands stand for because they do stand for different things. I think, as we go forward, probably as our false cycle, you'll see much better delineation between the two. I think one really clearly stands for technology, stands for innovation. They both stand for good quality. But the other one's clearly a little more of a fighting brand and we'll see products more aligned against that.

Your third question about music - we had some obligations to Apple that we've cancelled the iPod agreement in the late summer, I think. We've sold through that inventory. Clearly, us - that kind of goes - it's a very good example of Mark's - the partner - somebody that just takes our brand and slaps some components on it and we sell it. We'll talk more about a digital

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entertainment strategy later in the year as we finish those obligations to them. But we're obligated to provide iTunes, I believe, through January on our desktops and then we'll start to talk about some things after that.

Harry Blount - *Lehman Brothers - Analyst*

Harry Blount from Lehman. Steve, a question for you on the services side of the equation. If we think about you getting the services portfolio up to - particularly, managed services up to a profitability level that is much more acceptable and competitive and reaccelerating revenue growth in the back half of '06 in the face of a lot of industry contracts coming up for renewal, how do you give us comfort, A - that you guys aren't going to make some mistakes in terms of - take on some large contracts in order to win competitively against competitors? And then, what are the longer-term implications in terms of where you focus in the managed services sector?

Steve Smith - *Hewlett-Packard - SVP, HP Services*

Harry, I guess the first thing, we have put in place already the operating mechanisms that you - to manage, the discipline of saying yes or no, go, no go on a renewal or a new piece of business today. So, I wouldn't see any big change on how we would look at - and I think what Harry is referring to is an interesting phenomenon this year. In the year 2006, there's a very large number of renewals that are due for long-term contracts in the outsourcing business in excess of 125, I think, is the number. And yes, we are looking, technically, at which ones we might have relationships with and some of those clients may decide to change suppliers. We'll be very targeted, very focused on which ones that we can compete and when. And those are the ones that we'll focus on.

And I think, in terms of your confidence in us as we're fixing this airplane in flight, you can be rest assured that we're very focused on doing deals that are accretive to the portfolio and to the plan. So, we're mechanically (ph) focused on that. I would tell you that the mechanisms are in place to enforce it.

Mark Stallman - *Harrison Company - Analyst*

Mark Stallman (ph), Harrison (ph) Company. You sell AMD. Your competitors do not. Dell doesn't sell any AMD and IBM doesn't really sell AMD. That's going to change next year. How important is it to you now, the AMD effect? And what are you expecting next year and how will you address those changes?

Unidentified Corporate Representative

First, the AMD Intel solutions we offer, we believe that by offering that choice to customers, we allow them to pick the solution that's best for them. They both have their strengths. They both have - there's some balance in that cost performance ratio. So, we feel like we've created good solutions with both of those vendors. At the same time, for HP, as we've gone through some of the situations of chipset and chip shortages, the balance of competition is always a good thing in the supply chain world. So, having two vendors very aggressively coming after your business, we believe, is good for us, is good for the market overall and good for our customers.

As far as next year, we'll stay focused on our solutions, whether any of our competitors - I think you mentioned Dell and IBM - IBM Lenovo. We'll spend more time - we'll pay attention to what they do from a product perspective. I tell you, those guys at the low end of the line you can see come in with some different chip set solutions that are just cheap. The H'ers (ph) of the world. But we've got very good penetration of both products in that consumer space. We've seen, I think it's fair to say, good adoption in the commercial space of AMD products. At least good - a good willingness to review AMD products. And so, really, giving that choice has become important for us.

Ann Livermore - *Hewlett-Packard - EVP, Technology Systems Group*

And as you know, in the X86 side, we've had a dual supplier strategy around processors for awhile. It's working really well for us and has allowed us to really be able to manage our margin better from a mix perspective, based on what our current situation may be. So, we feel very good about it and you'll see us continue to very aggressively work with those in self (ph) and AMD on the X86 server side.

Unidentified Corporate Representative

I think, in closing, I think it's good - it's very good for HP to have two strong silicon providers. Yes?

Cindy Shell - *Morgan Cabot - Analyst*

Cindy Shell, Morgan Cabot. A question for Steve Smith here. We've heard you talk about kind of reigning in and getting more focused and disciplined on cost. But at the same time, I'm hearing you talk about looking at business process outsourcing, which I always thought was a bit of a stretch for HP. And I'm seeing HP listed as one of four companies still in contention for a $15 billion contract with General Motors that should be announced next month. That's three billion a year with GM. That's what you did in managed services last year.

It feels like a stretch. I'm wondering if you can reconcile, still pursuing the General Motors deal. With them on the brink of bankruptcy, a lot of risk there. BPO feels like at stretch with this sort of new discipline. And then another question for you after that.

Steve Smith - *Hewlett-Packard - SVP, HP Services*

Okay. In terms of the pursuit of the client you mentioned, as you know, we're not going to talk about that publicly, although it's out there. I would say this about it. It's - the kind of work we're bidding on there is right in the sweet spot of what we do. It's infrastructure based. It's application based and it's no more complex than any other implementation and we're doing it. It's big, as you just stated. But it's right in the sweet spot of what we do for a living.

In terms of the BPO, as I mentioned earlier, we're a mile deep and an inch wide in the financial and administration capability in that area. And that's where we've focused for the last 12-18 months. Where we will branch out of that focus is if there is an opportunity, for example, like payroll, that might be - that could - some clients call it an F&A function. Some clients call it an HR function. And if it's tied to some technology or some R&D advantage or something we're doing internally for HP and it's within our core, then we will look at it and, if we have a relationship and a position that can win, we'll do it. But we're very focused on the finance and administration horizontal, if you will, today.

Cindy Shell - *Morgan Cabot - Analyst*

On the renewals, you mentioned coming up next year. Generally, the incumbent gets it. They turn out a cost advantage. The client tends to not switch unless they're unhappy. Probably some unhappy customers out there and you may have special insight given where you came from. Do you really think you're going to see a big opportunity there or is it more picking up a few opportunities.

Steve Smith - *Hewlett-Packard - SVP, HP Services*

It's hard to predict. It's early days on that. You mentioned one earlier that's going through that same situation right now and the stated position there is to multi-source. I think that trend is out there today, where clients who have experienced a 10-year, 15-year relationship with a single source supplier are now looking at best-of-breed multi-sourcing.

So, where there's that type of opportunity, we're going to be interested. Where there's an interest and intelligence on our side, that the relationship is not where they want it to be and they're willing to change, then we'll focus there. We're certainly not going to go chase something where the incumbent has done a great job and spend money chasing it and not have an opportunity to win. So, it kind of goes back to can we compete and can we win?

Ann Livermore - *Hewlett-Packard - EVP, Technology Systems Group*

And Cindy, to your comments about GM, we have done a lot of managed services work for them over the last two or three years, so we've certainly had quite a bit of experience running systems for them in Asia, in the EMEA and in the Americas in environments like SAP and global product development for them. So, they've done quite a bit of testing of people already and we've gotten to have a taste of what managed services contracts are like for them. So, that gives us some comfort as we did this.

Steve Smith - *Hewlett-Packard - SVP, HP Services*

The other thing I would add to that, Ann, is when you have a requirement like that, it really does help you direct your investment in things like global delivery. If you look back in the history of global services or EDS or CSC (ph), big client opportunities really help guide your investment. If you can solve those big global requirements, it tends to help you get the IP and the delivery capability you really need to go repeat later on. So, those kinds of opportunities present a great opportunity for us, too.

Andy McCauley - *CSFB - Analyst*

Andy McCauley, CSFB. I've got a question for Ann on storage. Ann, in the disk market, you have a hybrid model with an OEM deal on the high end and your own solution in the mid-range market. And I guess, why is it strategic for HP to maintain a presence in the mid-range market and why not just go to a fully outsourced model in storage?

Ann Livermore - *Hewlett-Packard - EVP, Technology Systems Group*

We are very pleased with the technology position we have in the mid-range. So, when we look at our EDA offering, we believe that's an area where we can really provide quite a bit of innovation from HP. We also think that the work we've done in the MSA space, the low end, will find its way into the mid-range over time. And as you look at whether it's the server market or the storage market, we believe that being strong in the low end gives you strength over time in the high end as those cost models and some of those technologies make their way higher through the staff (ph).

So, when we look at our investments across storage, we're very focused on deciding where do we OEM technology and where do we invest and have our own. And we're quite comfortable with the current set of decisions we have across the MSA, EDA, XP line.

Mone Reba - *Investor Group - Analyst*

Mone Reba (ph), Investor Group (ph). VJ, (inaudible) and with the digitization of the printing market, don't you see a lot of crossing between compute and image? We haven't heard anything about new products addressing this intersection. Are you

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going to leave this only to third party or there is added value, since HP have the printing and have the compute processing power?

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

Sure. I think one example is the introduction we had yesterday about the halo collaborative room that we introduced. That's really a great convergence of the computing power that HP has and other imaging. Because we fundamentally believe that it's a tremendous opportunity for us in bringing completely new business model where most of the business customer right now - most of the (inaudible) - they spent 50% of the time on the road.

And -- instead of on the road and on airports, the big collaborative room, they will be able to do their decision making in a couple of hours and in (inaudible) because that experience is very, very volatile. And we couldn't have done it without the networking capability, the services capability that Ann has and the imaging capability that we have. I think what we are going to do is we're going to be very selective when we see real opportunity in running the business, not only for the sake of (inaudible). I think that's the first reason to take.

Mone Reba - *Investor Group - Analyst*

Second question for Ann. It seems like the competitive state is starting to change again with -we've seen IBM very aggressive in the enterprise, but now we're seeing Sun come back with two major product introductions. Dell is -- we haven't heard anything about Dell in the server market from the three-year representation except limited. What do you see happening in the server market overall and the dynamic change that's taking place relative to, say, last year?

Ann Livermore - *Hewlett-Packard - EVP, Technology Systems Group*

If you look at the server markets, one of the main things that we see happening is most of the growth, when you looked at the market growth rates I've showed, being in the X86 market. And clearly, from an HP perspective, that's a market space where we've had leadership for the last nine years and feel very good about the business model we have there as well as the capabilities. At the same time, you see the fastest part of the X86 market being blades (ph), from a growth perspective. And blades, like we discussed earlier, requires value selling skills, not just selling boxes.

But you need to have the cost structure of the volume model. So, we see those trends happening and depending on our competitors, you can play out whether they've got the cost structure or whether they've go the value system selling capability or whether they've got both. And that's really going to speak to them, Sun trying to be in the X86 market. That's a way different cost structure than what they're used to today. Or perhaps Dell trying to be in the blades market where they're not real deep in their solution selling capability. So, we think those market trends are going to be quite critical to some changes in the landscape.

Richard Tranum - *Merrill Lynch - Analyst*

Richard Tranum (ph), Merrill Lynch. A couple more for VJ. On the consumer printing market, what are you assuming price declines to get to the 13-15 operating margin guidance? Separately, you alluded a couple times to an interest in getting into the retail development market you already have, really, online in the home printing. Can you help us understand a little bit more explicitly how you plan you accomplish that? How fast does it happen and what kind of growth we can see from that. And then, finally, within those three, how do you expect the share to shift between online home printing and TS over the long-run?

VJ - *Hewlett-Packard Company - EVP, Imaging & Printing Group*

Okay. So, three questions. The first question is with respect to the low end of the consumer market. We fundamentally believe we are playing in all the price points. So, we start at $39, $49, $79, $99 and then $199. The first thing we are doing is with scalable printing technology. We introduced 8250, which is the fastest photo printer in the world. But we are seeing that we have been selling up. So, we are actually seeing growth in $199 sector, which is very foreign for us because we know if the customer is going to spend 199, they're going to print a lot of photos. So, that's the first thing that you will think about when we look at 13-15% operating profit. Because you get profit both in ink and the media.

The second thing is all in one, we are participating at $79. But we did some phenomenal cost structure change into our hardware design, so that we will be able to profitably participate. And the supply that we have design is also further design to go offer at the low-end market. So, those two things are very important. Now, $39, $49 - we can be very selective. Because we absolutely believe that you want to save (ph) the customers who are going to use a lot of ink.

Answering the second question, we fundamentally believe that we have an asset, especially with chemical (ph) printing technology, to go up in the retail market. Stay tuned in terms of what we are going to do there. With respect to Snapfish. We acquired the company. We went from 14 million customers to 20 million customers and these customers - we are really understanding who these customers are, what their habits are and we're going to apply that to really drive our ecosystem. And I think that position that we held out in Europe now will also develop (ph) our footprint.

Unidentified Corporate Representative

We have time for just one more question.

Harry Blount - *Lehman Brothers - Analyst*

Hi. Ann, it's Harry Blount from Lehman again. One area that has been peripherally mentioned here, but seems to be an important of the strategy going forward is software. And I noted in the guidance slides, that's a 10-15% growth compounded target over the next two years. But relative to the size of the hardware business and to the competition, that still seems relatively small. And given your current portfolio with open view, that doesn't seem to have all the solutions that you need to really deliver on the division of the adaptive enterprise. So, why shouldn't we expect that to be much bigger going forward and what pieces are you missing?

Ann Livermore - *Hewlett-Packard - EVP, Technology Systems Group*

In the management side, you'll see us continue to be very focused on ensuring leadership in all the areas other than the mainframe associated management. For unified IP management. We have continued to invest and growth there, both organically and, perhaps, with some addition M&A actions as well in the management side. In the software side, you'll see also us making investments around the categories we talked about - management alongside automation. The virtualization space, where we're doing quite a bit of work. And then, as well, some of the areas that we've talked about, like our security investments around identity management. So, you see a lot of that inside of our portfolio.

We're pleased with the balance that we're having. And what you're going to see us do is really focus on having our software business models be profitable, be robust. We have actions we want to take through this year, much like we've already started driving down the breakeven point. And then grow on top of it. But right now, the areas we're focused on - you heard me talk about all of them in the presentation today - so, you won't see any surprises that talk to both those areas.

And we'll continue, as I said, with the strategy we've had of both the organic as well as inorganic work. This software pulls a lot of business for us, so I don't think it's fair to see the value of it, just based on the $1.1 billion of revenue that it generated this

year. It pulls a lot of other business and creates very sticky, very intimate, very important relationships for us, from a customer perspective.

Unidentified Corporate Representative

Okay. So, we're done with the Q&A. And now, we're going to invite Mark back up to make some closing comments. Thanks.

Mark Hurd - *Hewlett-Packard - President and CEO*

Thanks (inaudible). Steve, thanks. Okay. Let's summarize. I would - there were a couple questions that came up in the Q&A. First, the question about storage. I would like there to be no confusion. There's going to be more data created in the next five years in the history of the planet. And the storage marketplace is an important market for us. The same thing with the software market. There's going to be a lot of intertwined pull-through and the software market isn't just important to us in raw scale and raw profit, but important to us in the integration it has by automating processes, integrating with our service business at the same time.

So, these are both integral parts of what we want to do going forward in the enterprise. So, let me attempt to close up. We've covered a lot of ground over the course of the morning. We've talked about market trends. We've talked about growth rates in certain markets, the incompetencies and assets we think we bring to those trans-growth strategies. We've talked about cost structure. Cost structure comes at HP in terms of cost of goods sold, cost of services, op ex. We've talked about go-to-market models. We've talked about various segments. We've talked about changing our accountability and responsibility levels across the company and I could go on. So, we've covered a lot of terrain. I'm cognizant that we haven't had time to answer all your questions. But I would tell you that the good news and bad news is kind of one in the same. We've got a lot of stuff to go work on.

And we're going to go do that. I don't want anybody to perceive that we believe that Q4 was an ultimate victory for the company in any way, shape or form. I think it's the beginning of us trying to improve on what we do. And I would close, really, with the message that I closed on this morning. I do believe these market trends that we discussed are going to happen, regardless of Hewlett-Packard. I do believe at the same time, they execute to - or they align to HP's strengths. And I believe we will drive on the strategy they we described today. We've got strong assets in our core portfolio. As also, as I think you heard, adjacent opportunities related to that portfolio that we can leverage and expand in. We've got the benefit of a strong capital structure. We will align that capital structure to both blow as well as to save money going forward as you heard from Bob.

I do believe this whole issue around the assets in the company from brand, people, the whole technology base that we bring to market is strong. In the end, I meant what I said this morning to you, that this whole issue about accountability and responsibility - you may not always like what we say - I know some people didn't earlier in the morning - but we'll go - we'll go do what we say. We'll work exceedingly hard to deliver on the commitments that we make, both inside the company as well as those commitments outside the company. And we will get about the job of doing that as we close this session out.

So, let me try to close. We're going to close the formal part of our program with that, for those of you that are on the web. For those of you here at the room, there is a lunch provided next door. I can't give you more discrete directions than next door. And with that, you'll have members of the EC will be there. I'll be there for a period of time and look forward to seeing you then. So, again, thanks, everybody for coming and taking time out of your day. We appreciate it.