

HP
Moderator: Mark Hurd
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Laura: We are particularly pleased for this presentation, Hewlett Packard, but specifically for the speaker, in this case Mark Hurd, the CEO of Hewlett Packard, both for what he is doing with Hewlett Packard and also because this is the first time Mark has actually joined us at our conferences. And so we are, I guess I hope that all of you could give him a particular welcome. So we're going to jump right into questions and I hope some of them are not easy.

Mark Hurd: No, I thought this was a one on one you told me about.

Laura: It is a one on one, ignore everybody else. And when you joined Hewlett Packard, I think one of the key gripes that investors had was that Hewlett Packard was pretty inconsistent and there was very little sustainability. There was too much forward movement followed by backward movement. What we've seen over the past 4 quarters has been some pretty steady improvement. Maybe you could briefly start us off by talking about some of the changes that HP has made in its progress or infrastructure, apart from the restructuring that has gotten you to this point.

Mark Hurd: Sure, I'd be glad to. I'll try to be as concise as I can be. To a point I think our results have been volatile, I think is probably the best way to describe it. We have been able to grow. But within the context of growing, we put revenue on the top and frankly not a lot spread through our fingers after we would grow. And that really has, that's why our Q2, while a decent quarter for us relative to the external view, we grew about \$1.255 billion in revenue and when we were done we had about \$30 million. And so while that was okay relative to what the estimates were on an absolute basis, the ability to put 1.2 billion in your hands and only have 30 million bucks, is probably not a model we want to sustain long run.

So you really get down to what occurred for us. We had both an issue with mix, the mix was skewed to the low end of our product line, point one. We had some gross margin and pricing pressure. At the same time we had sloppiness with our expense structure. And when you add those together you get the kind of results that we've had. So we've tried to focus hard on changing our destiny and that started for us by trying to change our operating model. As I know I've said to many folks in public audiences, I'm not a big fan of matrices to create breadth of organization or layers of management to create depth of organization. That creates cost and actually creates slowness of operating speed. And the people that we've had running our businesses, we have 3 big businesses, and when I came they had roughly 30% of their costs and expense in the P&Ls and we have now changed that. They have roughly $\frac{3}{4}$ of the costs and expense that is in their P&L directly in their accountability. They have eliminated layers of management. We are trying to reduce

and collapse matrices. As part of that we also attacked our cost structure. We've talked publicly about the fact that we would have roughly 15,00 people in jobs depart the company. We're about halfway through with that exercise.

But I would also tell you, Laura, that we've got analyst's estimate, that's my prognostication, that we'll do in the ballpark of \$91 billion worth of revenue. And you know, when you go to subtract profit from revenue you get everything else in the cost. So we've got a lot of costs that we would have to go attack so that we can actually leverage our business in a more efficient, effective way. And I believe cost and growth are interrelated, so we'll never be done attacking our cost structure in as an aggressive way as we can so we can get to the market and be more competitive. And I believe in my sole if you don't have the right cost structure, you don't grow as fast as you could.

Laura: You indicated recently, actually that you have seen I guess "steady" demand. To what extent are there actually differences in the level of businesses that you see in key geographies? U.S., Europe, Asia?

Mark Hurd: It is different. I think on our conference call I did use the term steady. I would describe that as across the macro environment. Yet we see stronger demand in eastern Europe than we do in Western Europe. We see stronger demand in parts of Asia than we do in Japan. And we see relatively steady in the U.S. So that would be the way I would describe it geographically. We've seen relatively strong demand across our personal products division, our personal systems group, strong demand in notebooks. You saw that in our results in Q1, steady but not all that exciting frankly in the desktop space as you see continued shift in mobility. Strong growth as you saw by our printer unit performance. Again 12% unit growth in the quarter. Again it was steady and that was pretty steady across geography. So a little bit different based on geographic mix, pretty strong across our businesses. I guess strong means pretty consistent across our businesses.

Laura: Let's talk about growth a little bit. You grew at 5.5% in constant currency in your fiscal '05. And then your intermediate term fiscal '07 targets are for somewhat similar top line growth. But in contrast, early fiscal '06 targets, at least in constant currency is reflecting somewhat higher growth. So what are the drivers actually that can realistically move your growth higher than simply mid single digits? And short of a large acquisition, is any of this sustainable over some timeframe?

Mark Hurd: Let's not talk about acquisitions for the sake of this conversation and stay focused on organic growth. In Q1 we produced 8% local currency growth, 6% dollar growth in the quarter, and I think that was good performance for us. It had a different result by region, to your point, a different result by business, but again strong growth. I think the way we want to build our economic model, though, is to build our economic model on reasonable growth, yet simultaneously within our cost structure position ourselves so if the market shows up with more opportunities, that we seize that opportunity. Whether that's to gain share, whether that's we better position ourselves with our technology and go to market model to get more growth. But we want to build a financial model built on reasonable amounts of growth, i.e., the targets you've described, we can produce a reasonable return for shareholders.

So I think you're going to see us continue to pursue the kind of growth rates that we've described and we'll continue to articulate those kind of growth rates. Now underneath that, we've got several drivers for growth. I think we're trying to be as articulate as we can be about them, but HP is a very strong engineering driven culture. And what that typically translates to is great technology. So there is probably more technology in this company than I could ever have imagined. We always don't do the great job productizing it and certainly don't do a great job monetizing it. For us though, we really need to get after the enterprise. And if you broke it down into enterprise, SMB and consumer, for us, the enterprise segment, the top 2,000 accounts on the planet, when you go out into '08, '09 will probably do \$750 billion

worth of revenue.

We certainly don't have anything like commanding share of that market. Yet when you go segmented, and I try to use the comment, in our organization, if you interrogate the data long enough, it will confess to you. Our data tells us very clearly that where we have coverage, where we have sales people who show up, who are articulate and who understand their customer, our market share exponentially grows. Where we bring intellectual property into an industry like what we've done in telecommunication, our market share exponentially grows. Where we have software, i.e., Open View installed as the infrastructure management software, our market share grows. Where managed services is positioned properly with a significant position, our market share grows. Those 4 things quickly tell you, we need coverage, we need more IP, we need to make sure we lead with software and services. And when we do, our blade and storage and everything else gets pulled through. So in the enterprise, that is a significant opportunity for us to scale.

Do I think we'll be perfect and nail it all next week? No. Will we have to spend some money to scale our go to market? Yes. We'll have to finance that out of the cost reductions that we're currently making in the company so that we can fund that. It will take time for us to mature. Do I want to build all the potential growth that's opportunity for us into our model? No. But yet position us to go get it if the opportunity is there.

Laura: You've been asked repeatedly, you're probably tired of the question, whether you'd consider disposing of some of your larger businesses. For example, PCs and printers, and you indicated that it wasn't under consideration. But we're actually wondering whether there are some smaller parts of businesses that are either no longer strategic to HP or have become serial under performers that could be divested and be part of this sort of progress forward for you?

Mark Hurd: In fairness, I mean, I think in terms of disposing of some of our bigger businesses, I'll never guarantee you you anything other than I have no emotional tie to any business or any segment. My view though right now is we're not - - what I'm trying to say, and I think I've tried to us a point of reference, we're not working on spinning off any of our three big businesses, not working on it. Don't think it would be wise and we'd go into a lot of debt. But what's underneath that, we question everything. We look at return on capital models. We look at opportunity to grow share, the leverage that it brings to our portfolio, the aftermarket opportunities those bring, and the strategic linkage it has for our businesses. So I think it would be fair to say, Laura, there isn't any GBU that we've got in the company that we don't ask a lot of hard questions to. It's one of the reasons we're not in the iPod thing today. I will tell you publicly I've never questioned a segment win, because the minute I make a statement about it, we wouldn't be in it anymore. So I'm not going to go there other than to say we're either looking for a business that's got to explain one of two things to it How you make money or how you put us in a position to make exponentially more money in another business for us. If you can't answer one of those two questions, you're probably going to be under a lot of pressure from management.

Laura: I guess similarly you indicated on your last conference call that you were going to use some of your margin improvements and some of the future restructuring savings for demand generation, particularly in the commercial printer space and also in your enterprise group. I guess can you give us some more specifics about product areas and also what you mean by demand generation? And should we assume that this means targeted pricing action?

Mark Hurd: No, I wouldn't necessarily go there. I would say the fact that we've obviously got - - we've got a couple of problems, or I could actually describe them as opportunities at the same time depending on your view. One, we haven't performed as well as we need to from a financial performance perspective which means we have to save money so we can improve our financial performance. At the same time, there were growth

- - I wish it was as easy for us, if I thought the opportunity at HP was as binary as just cost reduction, then we'd optimize HP on the cost line and therefore we'd have the ultimate, I don't believe that. I believe the company can both save money and grow at the same time which makes the exercise a little bit more interesting from an operational perspective.

We look to save money. I'll give you an example. We need to go spend money to go sell more. And that sometimes winds up - - I'll give you a simpler example in direct sales people. We need to show up at the points where products like ours, whether they're multi-function printers, whether they're printing to the enterprise, whether they're - - a great example I just gave you in terms of our enterprise solutions like blades and storage and services and software in the enterprise, those opportunities again, where we cover, we get exponentially better market share. And never in my career have I ever learned that to go build a great piece of technology or build a service so you can purposely under distribute it. So at the extreme, we want to go to the buying points and we want to cover those. But we want to cover those points where we get the ultimate production of gross margin relative to spending the least amount of money to do it.

So we're in the process, Laura, of understanding every segment, every geography, what the market opportunity is, what our position is, and what the ultimate deployment of capital would be to in the end produce better financial performance for us. So that creates for us we've got to take costs out. Like I said to you, we'll never stop taking costs out and hoping to realign our capital both at the bottom line of the company but at the same time to invest in the opportunity for us to scale the company going forward.

Laura: What I'd like to do now is kind of look at some of the divisions and then, although normally I would never start with PCs, there has been some controversy recently, so I'm going to start with PCs. You may have noticed, I guess, over the past week, I think many of us have noticed that several key notebook suppliers have commented about excess channel inventory. And of course we hear the words channel inventory and everybody goes ballistic, particularly in Europe. With Acer and Hewlett Packard as the main participants in this market, could you give us your perspective on where things stand at channel inventory levels, maybe particularly in Europe but also worldwide for HP and the industry. And then I think as a corollary, there has been sort of the additional note of specific indicators suggesting that Hewlett Packard has engaged in some order cutbacks in the supply chain. If you can address those 2 elements, that would be great.

Mark Hurd: I'll take the second one first. We probably cancel orders every 20 minutes and realign our order flow dynamically. So I would bet if there's a question about us canceling orders, those are probably true. But I don't know anything about any abnormal order cancellations in our supply chain, so unless somebody's got some subterranean flow of activity that I don't know anything about, I would argue to you that's probably not material or relevant information. In the channel, I don't know how to be any clearer about it. We don't have excess channel inventory, full stock. I don't know of any incentives that were placed to put more inventory into the channel. We grew our revenue, increased margins during the quarter, and had in almost every segment, lower weeks of inventory as we did it. So I don't know what more to say about it other than that's where we are. We don't need - - you saw the quarter we reported. I want to tell you - - the last thing we needed was to be doing stuff like that. I mean we did about 22.7 worth of revenue, our margins were up. It's just not a practice that we're working on. So I don't know what more to say about it, Laura.

Laura: Well if we can just continue forward on the PC front before moving elsewhere, you have now put together 6 straight quarters where PC operating margins have kind of edged, have improved sequentially. And you're now essentially at the low end of what you say are your longer term targets. From here, should we expect to see I guess, a small pullback on a quarterly basis due to seasonality? Maybe more aggressive placing? What does it actually take to get you to the higher end which is 6%, of that 4 to 6% targeted range for PCs?

Mark Hurd: I think the PSG group has just done a great job, not just in the last quarter, but over a period of time, in improving their operating performance. And I think it happens when you have some growth and you're tighter on your operating model. I think for us the more relevant issue for us isn't share, it's really the mix of the share or attach. So we don't spend a lot of time worried about whether we have 17.7 points a share, or 17.53 points a share and get all motivated or all depressed depending on how that works. We have some people that get worried about that, but we want to keep a reasonable share count, but it's much more important to us, the basket of goods that we sell. And the attach rate in our ability to add value and add accessories to that basket. That provides profitability.

So for us in the end to be focused - - I don't know where you'll take me on our channel strategy, but clearly some of the work we're doing is to align our channel strategy and our go to market strategy with our ability to become more profitable. That directly relates to the basket of goods that our partners sell as well as what we represent in the market and how we sell them together. That is a lot more important to us than whether we have this share or that share. So that's what we're working on. We're clearly trying to work on our cost of goods sold. We're trying to work on our warranty costs. We're trying to work on our partnerships. Clearly the mix that we've got of suppliers now between Intel and AMD is an important dimension to us and we're trying to work all those levers, if you will, simultaneously to improve our profit. I won't prognosticate next quarter's profitability, I'm going to say typically in Q2 and Q3 we have a seasonal dip in our revenue which is what we described in our Q1 call.

Laura: If it does in fact turn out that ASO or some other vendor has put too much inventory into the channel, how does a company like Hewlett Packard avoid getting hurt if pricing becomes more intense?

Mark Hurd: I would actually think of that to be a good thing for us competitively. So the more that you get companies strung out financially and the ability to have to do EOL or end of life kind of pricing behavior, the more you'll cause future pricing problems. So it's a zero sum game. Once you get caught with channel inventory and then you want to go merchandise that through, you'll have to have something - - it's like a Whack-A - Mole, something else will pop out somewhere in the financial equation. So actually I would say it the other way. If in fact, and I don't know enough about ACER and what their channel specifically looks like by country, by product, but if in fact they sat there with more channel inventory than they needed, and we sat there in the situation that we just talked about, we would actually have a competitive advantage that we could leverage over that period of time. So now I don't know enough to know whether that's the true situation.

Laura: I guess in a similar vein, and then we'll close out in PC, although we'll do a little bit of a segue - - how worried are you actually that Dell's lower growth and operating margin in its January quarter indicates that it's going to be more aggressive going forward and actually it sounds like that is what is going to be partly their strategy?

Mark Hurd: That would be better question for them than us. I think - - I just hope they want to make more money.

Laura: The segue, and you kind of opened it up, you mentioned something about AMD. You may be perhaps the only company with an objective enough position to address this question in some respects, namely the issue of say Intel versus AMD and in terms of your own perspective. And on that issue I guess there are a couple of questions. Certainly as we hear it, customers are increasingly embracing AMD based servers for power and heat related reasons. To what extent has this actually provided you with an opportunity to get an unexpected advantage, gain a little bit of market share during that shift?

Mark Hurd: Well the strategy that the company undertook predates me. And I think the strategy was well thought through by the HP team, I think probably well done. But it's all about, for us, getting the customer choice

at the same time as we have choice. And it gives us two elements of leverage, both market leverage as well as supplier leverage and I think both of them are an advantage for us. So AMD clearly has had pockets of performance that have been advantageous. You mentioned a good one about the power and heating issues that come up and particularly when you get to a very dense cluster of servers that are tightly bound together, you get a lot of heat and a lot of power requirement. And you get into a search application or hotmail application, you will get a lot of intensity around that specific issue. So I think to that respect it has been an advantage to us in fulfilling a market need. At the same time, Intel is a very big piece of our portfolio and an important supplier to us. We're in a strategic partnership with them around Itanium which is very important for us. And we're working very hard with the Intel team on it. So I don't look at it as yes, no, black, white, good, bad. We think there's a position for both. We think it brings a customer opportunity and market opportunity as well as a supplier piece of opportunity for us and so we plan to continue down that path.

Laura: So it sounds like Itanium is still a pretty big focus?

Mark Hurd: Well, I mean, listen, we're deep in it with Intel. We're over 7,000 ISBs deep into Itanium. It's a meaningful part. Integrity is an important part of our BCS product line, it's growing, as a part of our business critical systems, product line, sorry about that. So you're going to see us do more aggressive, continue to do more aggressive marketing with Intel. There's work being done at Intel. They're investing more money in Itanium now than they were last year. I think Paul and his team are very committed. And Paul and I are actually going to be doing some stuff on the road together over the course of the next month promoting our investment in Itanium and we clearly we think we're going to go get some market share. And by the way, the market position of our BCS product line isn't just unique to the performance of the chip. It's also about some of the work we do in compiling and so forth around the chip and around the chip set. So we think we add value above the chip and so we're pretty pleased and think we're getting a pretty good ISB group together. So we plan to go out and compete and try to win some business.

Laura: Just finishing up this whole Intel AMD thing, I guess under the assumption that Intel will be pricing more aggressively for the near term, I guess, and some people think, some people are thinking very aggressively, doesn't that give you and other systems companies a margin opportunity or room to price?

Mark Hurd: It's a good competitive market, Laura, a good competitive market.

Laura: But in addition, does it give Dell a better opportunity?

Mark Hurd: I don't know, because I think at the end of the day, customers want choice. Obviously AMD, when they get to a certain level of critical mass, obviously gets viable. They clearly had good growth. And so I think that the more - - let me simplify it this way, Laura. I very much like our position.

Laura: Any thoughts that you'd like to share before we move on?

Mark Hurd: Did I frustrate you with that answer, Laura?

Laura: There were several actually. That you'd like to share about, say the current gap between Intel and AMD and when you think that could start narrowing and - -?

Mark Hurd: I think Intel's pushing hard. So I think they clearly have expectations as they get later into calendar '06 that they will close the gap in some parts of the product line. So as we continue to tell Intel, performance and price and availability is very compelling.

Laura: Okay. Let's move on to, I guess another area, certainly a very important area. Printers. Without a lot of fanfare, your printer division, IPG, has been quietly repositioning itself to take advantage of growthier opportunities and more broadly defined markets. So looking at the core market to begin with, that is, not including some of these new areas, what does go forward growth look like in the core market before we start to pack on some of these new areas?

Mark Hurd: I think what we've been talking about is 4 to 6% growth, 13 to 15% operating margin and I think those are probably reasonable ranges to think about. Clearly, we tried to change our position in IPG. Many times when you have a blend company, a company being blended, company having multiple business models in the company, sometimes the good businesses add more than the good business really ought to be doing. And the easiest way for us to make money, more money in IPG is to sell less printers and it's an easy thing to do. You don't build as many units and you'll actually for a short period of time, make more money. Wal-Mart is not a healthy business model. So what we tried to do, way back in Q2 of last year, was to let that business go do some open field running. The fact that we weren't making money in some other business at HP while interest was not relevant to optimizing the opportunity at IPG. So we set about the opportunity to drive unit growth. And I think really, Laura, what happened in Q1 was probably more important because not just was the profitability being delivered, but they delivered profitability at the same time as growing units 12%. That's actually a more important answer than 14.9% worth of profits when in fact you can do both at the same time. And that's kind of a skill we try to develop to be able to do two things at the same time.

So I think for us, it's going to depend on what happens going forward in a couple of areas. One, to your point, there's a core market, consumer market, enterprise market, that are important to us. But at the same time, we're trying to invest in other markets. So you've seen us with at least 3 adjacent markets that we're participating in, one being defined as the whole retail online photo kiosk stuff. Secondly it's on the web. We acquired Snapfish. And third we acquired a couple of commercial printing companies. In the end, what you see us trying to do, we're not trying to become a web company. So when we bought Snapfish, our objective isn't to be an internet company. Our objective is while the pages in the marketplace are growing double digits, I mean, there's double digit growth in these printer pages, the pages are moving around. So they're moving to the web, they're moving to the store. And we want to be in all of those interconnection points, intersection points, where we can actually control those intersection points and have HP infrastructure in them.

So for us at Snapfish, we want to be, if it's on the web, we want HP infrastructure behind it. We don't actually care if Snapfish is actually the infrastructure behind Walgreens.com or they can brand it their own. We don't need to be branded Snapfish either as long as that's HP infrastructure behind it. The same thing in the store. When you see a retail online photo kiosk at a Wal-Mart or any store, our objective isn't because we've got some romantic attraction to be in the kiosk business. We want HP infrastructure though at that point. So I think for us, these opportunities, again, marketing collateral, marketing collateral was printed typically by small company. These are small printers. They're typically \$10 million companies and they're yours and my company. And the biggest decision they make is to buy a digital press. And so those things cost \$400,000 or \$500,000, they're in one place, they need to be serviced, they need to be supplied with aftermarket support. And all of that needs to be done by people who show up and try to service that customer. Again, we want to be where the marketing collateral is printed, we want to be where pictures are taken, we want to be in all of those intersection points.

Laura, what that will generate, I'm not 100% sure. The market is big. The opportunity is there. We think we're well positioned with technology. For the sake of where we are today, 4 to 6% growth, 13 to 15% operating margin. When I say 13 to 15%, I mean to 13 to 15. I'm not trying to tell anybody 14.9 all the time or 13.0 all the time. I think you'll see a range of performance over time within those numbers.

Laura: I guess just to be clear about it, it does certainly imply that the newer markets, should they develop as you would hope, could be added growth opportunities.

Mark Hurd: Could be. I think we've also got core things that we've got to do better. I mean, when you look at the multi-function printer market, it's a market that's typical of what happens to us. Here's a copier market, \$30 billion to client. Here's an MFP market, \$24 million growing. Inside the analyzer digital is growing exponentially. We sit here with what we think is the best technology on the planet Earth. We've gone in a relatively short period of time from zero to 16 or 17 points of market share. You say in one sense, that's fantastic. In another sense you say, why isn't it 40? If you've really got the best technology on the planet, you wind up with better share than that. What stops us? It's a long story, it's complicated and so forth. And we need to get beyond that to the opportunity to go nail these things. So I think right now we've got to get through some of our go to market issues, we've got to get through building out these adjacent things before we commit to higher performance. Right now we're trying to block and tackle and make sure we're nailing the market opportunities, particularly on the high aftermarket segments, that you're positioned well to do that, that we're performing as we stated, and that we're investing in disciplined, prudent way to go attack these, because if we do we could be better. But we have no commitment from me other than what I just told you.

Laura: So, you talk about 13 to 15% operating margin. You said 13 to 15.

Mark Hurd: Yes.

Laura: Now, we're a very patient bunch.

Mark Hurd: Really? I haven't noticed that as a trait.

Laura: Well we are, and I know that we'd all be absolutely patient if the number 13 actually showed up.

Mark Hurd: Sure.

Laura: But maybe you could state now, that is before it has, what would be some of the puts and takes causing a 13% margin that should not be sort of cause for a heart attack versus what are the contributors to a 15% margin?

Mark Hurd: Well, I think that would be a severe reaction. But I think at the end I would think that the things you would want to look at would be what we've invested to go after our adjacencies, what we've invested in our go to market model. And I think we'll try to be transparent around all that. The other would be what happens in pricing if anything happens in the pricing part of the market. That could have an impact as well. Those are really the variables. Our ability to get at the high usage markets. I think those are the things. You'll see us continue. We're not going to go back to the mode of not working to optimize our market interests. So I still tell you today I do not believe going again to artificially hold down growth in the effort to try to drive a shot term quarterly operating performance has been the long time interest of HP amongst any of our constituencies including our shareholders.

Laura: Why shouldn't we be concerned about the trend in ink? That is third party suppliers to one extent, more opportunities to purchase cheaper ink?

Mark Hurd: Well, I don't think it's not an issue. I think at the end of the day though, you'll see us continue to do the things that you would expect us to do. We will aggressively protect our intellectual property. So that

agreement that you find with many people who infringe on our intellectual property, we will pursue them aggressively, point one. Point two, you'll see us aggressively work on - -you've seen us move to more SKUs of ink. That's actually one place in the world where more SKUs is better, because the more blends of ink, the harder it is to copy and stay up with those trends. And you will see us align more ink directly to product SKUs as we do it and you'll see us team with retailers at the same time. I think there is opportunity there for us to continue to perform but we'll have to protect our IP, continue to be aggressive on the invention side and continue to partner as we have. So we'll see what happens.

Laura: As you broaden your printer strategy, your line up of competitors actually is changing from the traditional competitors - Canon, Epson, Lexmark and others, to include companies such as Kodak and Fuji, Xerox and so on, even Shutterfly. And does this help you or hurt you to the extent that the market is changing and some of your competitors can't fully change with this, but by the same token, you're fighting competitors on a lot of different fronts?

Mark Hurd: Well the market's broadened, I think that's the good news. That's the reason why those competitors have shown up. So as you see the morphing of the copier market and the printer market, I actually think that's an opportunity. And the more that you see digitization occur, those MFPs, multi-function printers, have to fit on the network. They become an IT decision as opposed to a procurement decision. That certainly puts pressure on some of those people that you described and gives us an opportunity, if we're good enough to execute around it. So I think the fact that you see the market space blurring, actually is a good thing for us because we think we come armed with the best technology, we feel very good about our brand position and certainly when you get into SMD and into the enterprise, pretty well positioned with most of those customer because of our portfolio of products.

Time will tell. I always like markets, though, that are growing. And we're consolidating, making our - - actually I see what's happened with the printer market and the copier market blending together, has made our market bigger and given us a better opportunity. Sure there's some competitors in there, but I think the trends within that market - - would you rather come at it from the printer, bringing copier capability into the printer? Or would you rather be in the copier and trying to deal with the issues around printing and imaging? I know which hand I'd like to have. So I think it's a better opportunity for us, but like anything else, we'll have to show we can go execute. And I think you've seen our technology drives a pretty interesting part of share or piece of the market. I'm just not sure we can't do even better.

Laura: The last, just to close out the printer segment and then move on, how do you actually balance the risks associated with ink being an extremely large part of your profitability, some would say maybe even too large and therefore probably needing to come down as you build up other parts of your business, with the need to continue to broaden the reach of the printer group in order to retain its margin?

Mark Hurd: That's a good question. I think that we think there's market for both. I mean, you can take parts of the market like marketing collateral, certain parts of marketing collateral, topography, where ink is really important. You get some parts of the market where speed and laser can be more important. So we think there is applications for both kinds of technology across the market. So our objective isn't to replace one with the other, it's to optimize the opportunity that we see out there. So we think that any technology, particularly with SPT, with our scalable print technology, as a very attractive segment, particularly as we work it, interrupting some of the cost points. I don't think, at the same time, one's ubiquitous versus the other I think there's segments where both play.

Laura: I guess I'd like to move on now to services which is an area that you made some very pointed comments on, on the conference call, very straightforward indicating that the growth of your services business would be compressed for awhile if you focused only on deals that made money and that HP could successfully

execute on. Which of your services areas actually fit those 2 criteria given your current skill set? Making money and being executed well?

Mark Hurd: Both our consulting integration practice and our managed services practice have pockets that fall in that category. We were growing exponentially. Most times that's a good thing, but we were growing unprofitably. And we don't have time for that. But then again, that will hurt our ability to grow further. So we needed to interrupt it, which is what we did. We stopped it, said we're going to be much more prudent and judicious about the deals we take. Deals have to have two characteristics. They have to be able to make money and we have to be able to deliver on the customers' request - - it's a very heavy reference selling business. So we'll screw up a deal and you'll hear about it for the next 5 years. But we have to be able to do both. The way to get more, better quality, isn't to short sheet a deal, so to speak. You've got to make sure every deal you do, you do better than the deal before. So we purposely scaled back on the growth with the objective of getting our cost structure right, getting our discipline right, getting lined up to be able to execute on transactions with both a good cross profile as well as a good delivery profile. We're making investments in that business at the same time to standardize on a global delivery methodology. I will tell you I believe products and services over the years will morph together. There will be a blurrier line between products and services. The way you get more profit in services isn't in the end to arbitrage labor and try to get labor 30% less, it's to eliminate labor. The way you eliminate labor is to automate tasks, automate processes. You do that through software. We need to invest, which is part of what we're doing right now, to invest in automating those processes to eliminate labor. I believe in the end services companies that are automated, driven by technology, have an incredible competitive advantage over guys that are shoving labor around as a core competency.

Yet we maybe have not done all the work that we should have done. So we're going back to the basics. Let's go back to our costs. Remember one time, one more time for us, revenue -- our expense structure isn't op ex. Our cost structure is revenue minus profit equals cost. A lot of that cost sits above the margin, particularly in services. If we don't get that cost right, get our processes automated, get everything lined up to be able to go to the marketplace and kick butts. And there's nobody in the market that should be able to compete with us maybe with one exception. And we need to make sure we're positioned to go take advantage of it. It that means we're going to wind up with 1% local currency growth for a period of time, so be it.

Laura: Should we actually be concerned that what you're seeing is the result of some unexpected results from earlier signed services contracts and it's going to pop up in unexpected ways in some forward quarter?

Mark Hurd: No, I wouldn't think that would be a concern. I would think that - - I think we know what we're doing. So I'll say it that way, in the sense that we know where our deals are profitable, where they're unprofitable. So I think the real issue for us, is do we get the work done I just described? Do we get our overhead costs to the company - - there's three levels of costs in services. The overhead costs of the company, i.e., the money that theoretically Mark Hurd spends goofing around at the HP co level and sends down into the businesses. And then there's the money in the businesses and TSG, our technology solutions group, that gets sent down to HP Services. HP Services has its own overhead costs. And then the actual costs of delivery, meaning the people to go deliver, the processes to deliver. We need to take costs out of all 3 and that's what we're doing right now. Once you do, and you automate your processes and you know what you're trying to get done, you will actually grow faster, I will predict for you. And you'll grow profitability. We're not in this to grow so we don't make any money. We actually want to grow and actually make money at the same time.

Laura: So then there's GM. Basically there were certainly a lot of people who look at the GM business and say that it comes with a relatively high risk factor but you increased your presence there. How does this fit in

with your profitability and execution guidelines?

Mark Hurd: So GM did a lot of stuff. I mean, they outsourced and went through a second generation bidding on most everything that they do. And so there's 2 elements of risk, I assume, from your question. One is the jobs that you take, and second the financial condition of GM, I assume based on what you said, but I'll comment on both. One, I think for us we tried to take deals that we knew we could execute. We could have bid on more deals, probably could have won more deals, Probably, maybe, but it was real important for us to get the deals and get contracts that we know we can nail, and we think we did that. We took deals that would fit in with the core of our skill set. And without getting into a lot of detail, we did a lot of work to insure we were aligned with GM on the financial issues, so I won't go into any more detail than that. So we were very aware of it, frankly we got through the financial issues earlier. We'll see what happens, but making sure we did deals with the right scope that we can deliver on, that's the place you get in real issues. So we think we took deals within our scope that we can execute on. I'm actually looking forward to it.

Laura: If we can, perhaps we can move onto the enterprise space, the space with so much leverage just for a moment. And that is, in your business critical server revenue recently grew by only 1% in the most recent quarter. Sales of your Itanium based servers didn't grow fast enough to offset decline in some of your legacy Unix servers. How much of your business critical servers are actually represented by Itanium at this point and how long will the drag from the other side of the business basically continue to have an impact?

Mark Hurd: Chuck, do we give those numbers out? Okay. So roughly you would have from our BCS business a quarter of a billion a quarter in Integrity. Integrity and Itanium are synonymous. So those are the numbers. Would we like to grow it faster? You bet. Part of the real issue for us growing faster though is ISA. So that's why the ISA account is so important to us and that's what we're doing. So I think in the end we actually look at a hybrid of server growth because there's the mainframe market which is declining where we have mainframes in the Unix servers. The Unix server market is actually morphing into the Linux server market. So you have to look at a blend of what's going on across all of those server segments to get a pure view of what's occurring. So you have to look at some element of our IFS servers, blade servers, across integrity and across our legacy space to get a pure view of the market. When you weave that whole story together, we think we're doing okay. If the question is, can we do better? There's no doubt we can do better than we're doing.

Laura: Sticking with the enterprise space here as well, you're closing in on the upper end of your 6 to 8% targeted margin. So how do we view this? Does this mean that you're going to need to - - that you're going to step back rather, invest more in the business, potentially generate more top line growth? Or conversely does it mean that you'll be needing to revise upward those targets in the not too distant future?

Mark Hurd: Well it won't be tonight that we do that. Listen, I think we need a little more time. We've got clearly estimates, we've raised estimates yet again, and we've got a lot of heavy lifting to do at HP. So I don't think we're going to run around and raise estimates every 15 minutes. I think our quarter was a good quarter, but I think it's a quarter. It's not the end of the game for us and we've got a big opportunity here and we want to do things in a systematic way that maximizes the opportunity for the long run. So I'm pleased that we had an episode like Q1 that we did, but I think our '07 model is our '07 model, and hopefully we'll see more of a trend that I likely would hope that we would have to revise those estimates upward, but right now I think we stick with what we got.

Laura: Tonight's a good night. You've been pretty acquisitive, small companies, but acquisitive over the last year. Adding to your software and services portfolio. On a longer term basis, how much of the 4 to 6% top line growth that you're targeting should we look at as coming from organic growth versus acquired growth? And are you likely to stick with the smaller acquisitions that seem so much easier to absorb?

Mark Hurd: Yeah, I think for us the way you should think about it that we'll continue to be somewhat acquisitive. But when I think of deals, and we talk about our ability to deal with them, there are two factors about the ability to work within HP. One is that they're financially sensible for us to do. Secondly, that they're operationally sensible for us to do. And meaning operationally for us that we can absorb them, we can integrate them and we can operate them without putting the company in operational risk. I think we have significant opportunities to advance business, so doing things that would jeopardize that, I don't think would be in the best interest of HP. So I think you can expect to see us acquisitive, but acquisitive that you're seeing is pretty much around the strategic things that you described. We think that we've got a play to make in servers, in storage, around the area of servicing and software that are very important to us. You've seen us add to our adjacencies in printing and those are places we really can be acquisitive. It's been things with Sytex which is actually the company that builds the kind capability to build banners that go across streets. You've seen us aggressive in the area of Paragroom that we bought with a software company. We bought Outer Bay which is an archiving company in the storage space, and again, a pretty similar space all across. So I think you should expect us to stay in that kind of area.

I won't say never to anything, but in terms of big, depending on your definition of big, I wouldn't think you should expect us to go out and do double digit billion dollar things. That wouldn't be what's on my mind right now. I'm sure I just did something I shouldn't have done, but that's what's on my mind.

Laura: You've talked a lot about aligning your capital effectively around your growth plan. Can you help us understand what it is that you're doing there?

Mark Hurd: Well I think for us, when we align our capital, both our financial - - capital has two points, human and financial. And we're trying to leverage both against both being more efficient and growing the company. And as I tell everybody all the time, we don't have the luxury of doing one or the other, we've got to do them both. So in the case of financial capital, we're literally spending money in the company now to reduce our expense. We're buying three data centers. We have 87 data centers and we've just got a mess through acquisition. And we're going through a process right now of integrating. We've got 24,000 servers, 11, 12 petabytes of storage on the floor, 270,000 devices running around the company, 3,300 applications and 4,400 times in 187 physical locations. We want to get all that stuff [indiscernible]. So, and we're trying to get our applications in under the 1,500 applications running 220,000 devices and we think we've got storage replication all over the place. Now we're very proud of our own technology so we've got it all over the place. And we can do better. So we've got 3 simple objectives in IP. Spend less money, have the best showcase for HP technology that you can possibly have and get better information for the enterprise. That's causing us to spend money right now so long run we can save money. That seems to be ample use of capital to save money. At the same time, we're spending capital to buy companies to the point you described which are acquisitive that are synergistic with our strategy. You'll also see us invest some of our savings in our ability to create more demand. So we've got to be clever in the way that we leverage our capital structure, both to grow and to save money.

Laura: I have a lot more questions, but we have a large crowd. Are there any questions? I think there's one here?

Speaker: Is it too early or should we see you start to gain some traction, because we haven't seen it yet, in the fact that you have AMD servers and Dell does not?

Mark Hurd: Well, I think to some degree there has been some traction in the fact that we've been able to leverage supply, we've been able to leverage price, and we've been about to leverage some market position. I think Laura was accurate with her point there's some markets where power and heat are very sensitive issues. And we've been able to leverage the AMD offer into the place that we sometimes wouldn't have been able

to compete because of the density factor in some of those applications. It certainly helped us on availability. In fact, Intel is now adding more capacity that's going to be helpful. But when we went over '05, there were some times we had capacity issues that we had to optimize as we went and it was helpful there as well. When you use the word traction, I would say there has been some. Is there more that can be had? Time will tell, but it certainly gives u options. And again, I don't want to make it sound like we favor one versus another, but we think there are various market positions that make sense and we intend to leverage those.

Laura: Questions?

Speaker: Mark, do you need to increase on the commercial printing side your sales and service and support or are you kind of happy where you are on them?

Mark Hurd: So yes and no would be my answers. We need more go to market energy. The fact, though for IPG, they've got a tremendous resource to leverage HP services. And we're not going to go recreate a new services organization, we're going to leverage the one we've got. We happen to be, in this country there's 13,000 commercial printers, low end commercial printers that we think are applicable for our market and we think we can get to them with certainly the same methodologies, proxies and tools we have in HP service. Might we have to hire a few extra feet on the street? Maybe. We'll do a lot of the work with remote support regardless anyway. So we think we can leverage the HP services asset, but we're clearly beginning to show up in some places and when you're a \$12 million printer and you're going to but a \$500,000 thing, you typically don't run it off HP.com.

Laura: I'm going to close it up with one last question which is, in looking towards fiscal '07, you provided operating margin targets of 7.5 to 8%. And presuming that you actually get to those targets then, or possibly even before then, what are the broad outlines for the plan that comes next? Is it 8% margins being steady state or are there things that you could actually do in the next phase to boost margins further?

Mark Hurd: So I'm probably going to stick with the guidance that I've given. I think, listen, if I thought HP's destination was only as good as that, it probably wouldn't be of all that interesting for me. Now that said, we've got heavy work to do in the company. I think - - I'm appreciative that people are pleased with where we've come. I don't want to minimize for any of you that fact that we're a big company with a lot of things to get done. We are simultaneously, the people of HP, - - I don't want to make this sound like a whine-o-gram or a commercial, but the people of HP are working really hard. We're taking out a lot of people, a lot of costs, we're trying to simplify our model, change our model, change our processes, deliver growth and earnings at the same time. As easy as it might sound, if we had a spreadsheet up here, there's a lot of lifting that we're doing at the same time. Do I think we can do better? The answer clearly is yes. But we need to get done what we committed to along the way. And I think we have opportunities to grow, I think we have opportunities to improve our costs and I think both lines can be significant in the ability to deliver improvement for us. But Laura at the same time, whichever one of those fits, we've got to go do them. We've got to go show up.

Laura: Please join me in thanking Mark.

Mark Hurd: Thank you.