

FINAL TRANSCRIPT

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PRESENTATION

Scott Stallard - *Hewlett-Packard - Senior Vice President*

Good morning. [Ben], thanks for the chance to participate here today. It's a lot of fun. We had our big security analyst meeting yesterday, and had a lot of information that we can add on to -- with the content that I go through today. So, I think the first couple of slides in the deck here are the one's that Brian put in for me. Let's get through those, and really talk about Enterprise Storage and Servers. We made significant progress over the last four or five years. I'll show you some of the background on what we've done to get this business on track.

Essentially, the assets that makeup Enterprise Servers and Storage were largely the assets that we did the merger with Compaq for, and brought along the additional assets at the time, Digital and Tandem or NonStop at the time. A lot of what we've been doing is guaranteeing that we achieve the revenue and cost synergies and value synergies that were originally contemplated by doing that merger.

So, first few years were really all about, mapping the R&D roadmaps, account teams, supply chains, all that getting common part numbers and stuff like that. It's not all that much fun or visible to people. But now that work is behind us, we're starting to see the advantages for which we did the merger in the first place. In addition, it's allowed us to have an organization and a business model that is at an interesting intersection between value and volumes systems. We think it really plays to the strengths to where the market is going.

We're really excited about the prospects for the future, and certainly think this last years performance is any indication, hopefully prepares us well for very successful '07 and beyond. Before I get on with Enterprise Servers and Storage, I wanted to just pull one slide forward from overall HP review, so you can see as a backdrop, kind of how the company did overall. We had about 6% revenue growth year-on-year or 7% in local currency. We had 47% improvements in operating profit, and record cash flow.

What was more significant than that though, is really for the first full, first time in a long time we saw tremendous participation in all product category and segments across the Enterprise, including mine. So, I can tell you for sure, the Enterprise -- or the imaging and printing group, who for a long time carried the weight of the earning per share load of the company, are certainly happy to have us pulling our weight. In the case of my business, we were 19% of the business overall from a revenue perspective, and close to 20% in the top [rating] profit for the full year '06.

This picture depicts essentially that first point which shows that Enterprise Servers and Storage is 19%, you can see the other parts of the Personal Systems Group, Imaging and Printing and so forth. Within my organization, we have three major groups, the industry standard servers includes the ProLiant group, as well as the place we have chosen organizationally to center a lot of our blade growth. Even though a lot of the Blade Technology is coming from other parts of the company, we decided to put it in that model because we wanted to take advantage of the low cost, high volume velocity that that model affords us.

Business Critical Servers is now, as of November 1, a combined organization that includes all of our Integrity, both and Standard Integrity and Integrity NonStop, as well as the completion of the retirement of PA- RISC and Alpha Admits Technology. So, it's really the coming together of our high value server category. And then storage is, I'll show you in a minute, is really four businesses underneath there. Between Tape, Storage Area Networks, NAS and Storage Software.

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So, it's a very complicated set of portfolios. We have about six routes to market, multiple categories. And the attempt that we have been, we had and wanted to be able to create; when we created this business was to really get the best of both worlds. We have a motto around our organization called "Better Together". There are places where it makes sense for us to collaborate in design, supply chains, marketing, sales.

And there are times, that allows us to compete effectively, we think, against overall system vendors that have an asset of portfolios, perhaps similar to ours. But we still wanted to be able to focus individual teams against a more targeted and focused or silo'd competitor. And being able to do both is an important piece to being -- of our competitive advantage and that how you operationalized organizationally those disciplines, is been the thing that I think has unleashed a lot of the power in the ESS organization over the last year.

This chart shows last nine quarters of our revenue and margin expansion, so it's been a good story this past year. Our revenue was up 4%, so we hit the low end of our guidance for the year. But, our profits were up considerably, up 81%. I can tell you for certain that every time we went through the year achieving those extremely high profit levels, what we were really hoping to do is ship the little more balance towards growth. That -- as I'll show you in the next slides, is really our mantra going forward.

Now that we have showed some sustainability in our business model, the effects of the various things that we've done to get the business on track, it affords us the chance to invest for growth moving forward. You can see the balance of profit and different revenue growth factors that we've got in there. Some of the more significant areas that we've invested in for growth, around Blade Systems, our mid-range and high-end storage arrays, and software. As well as our Integrity or our Tandem based value servers, where all areas of strategic growth that we identified early on, and are also the ones that are performing the best for us, per plan.

However, the story of our margin turnaround has not been one of just the last year. You can see this slide, going back to '02, shows that we've been making considerable progress over this period of time. And this about \$1.7 billion turnaround here in business performance, and this is the point here when I talk to printing friends they say 'thank you very much', cause it's allowing them now to be, to be able to be competitive within their own business and again, not have to carry the weight of the whole company.

As you would expect as well, as our business does better, there's an associated drag with other parts of HP, in particular, our Technology Services Group is part of HP Services, is largely viewed as in the same system or provent pool in our company. So, as we go, many of the support elements, for support and mission critical services as well, come along from that perspective.

What I listed on the right hand side here, were the themes that we worked on when we had a really horrendous quarter, ten quarters ago, when it really was a catalyst for us to complete all the merger synergy activities. I won't go through all of these, but some people have asked, well, why did your business turnaround? Is it just a one time thing? Is it systemic? Is it really just 'because you put [AMD] in? You get all these questions. Really, the answer is all of those things. It was around discount management. It was really around increasing our average unit prices through an effective use of both direct and in-direct programs to cause our attach rates to me much, much higher.

As you would expect when you sell the prize with the burger, or when you sell memory cards, storage and services in support, along with the core hardware offerings, it offers the prospect for higher gross margins and operating margins as well. In addition, because we now have a better line of sight with our customers, both directly and indirectly, we're able to shape demand. Both the steer products -- [steer arts] demand towards products that we have supply for. But also to steer our customers to an upsell opportunity as part of the sales process. That's been a key enabler for us to drive our attach rates up and our mix to a much richer configuration.

In addition, we've made investments particularly in the Global 2000, our top named Enterprise Accounts around the world. That additional sales coverage and the account plans around that, have given us more half-backs if you will, compared to two years ago. When we show up, we win more. Two years ago, interestingly, our win rates and our counts were actually too high. So it

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signaled to us that our, we didn't have as much a product issue as we just weren't showing up in the right accounts at the right time and we are well down the path to mitigate that situation.

And of course, as part of this is a backdrop, we've been driving against benchmark cost structures. A lot of the discussion of the last couple of years has been around the restructuring of a lot of parts of our company. And some of those efforts, as Mark Hurd and the EC discussed yesterday are on going. Particularly around the real estate and IT parts of the organization. But we've made considerable changes in our R&D composition, as well as marketing, supply chain and everything. And so, every line item in our business I can guarantee you is a whole detailed breakout by region, by product category to ensure that every last dollar is spent in the competitive way.

And if it's not there now, it's on a path to get there, and there's a very rigorous review process to ensure that we achieve those goals. It's just a business fundamental. It's not the thing that's driving us at this point, we're really driving around growth, and delighting our customers every day. Coming out of the merger, we got into a mode of where we actually got very good at reducing costs, and we've continued to do that under Mark Hurd's leadership as one of the three key anchors of his strategy of, efficiency or cost, growth and capital.

Lastly, one that I think the key strategic knobs for us, that we identified about three years ago, was to have a systematic way to migrate our R&D investments from areas that were good, but they were adjusting in areas of the business that just didn't have the growth prospects of others. So we actually as a team, again the better together staff that we encouraged in the various server groups, found a way to identify those opportunities. We actually freed up money and reduced the costs from maybe more of mature businesses and migrated into areas that have truly paid off for us.

And I'll show you a couple of examples right at the end here. One of them being our Blade System that we just came out with, our c-Class, here in the last few months. It was really all of those things together, have shaped the new Enterprise Storage and Server business unit that is now poised for really an excellent position as we move forward. Using a key business levers that we looked at in '07, I won't go through all of them, we clearly are aiming at category leadership in all of our main product categories. But we're really focused on Blades and key parts of the storage business as well and of course our Integrity Servers.

We want to grow in everything and do extremely well, but these are three areas that are very, very key for us. We also need to capitalize on our go-to-market motions. As I mentioned, we had a big emphasis on our Global 2000 over the last year. This year we're augmenting that with an increased emphasis on what we call our mid-market or kind of that next 8,000 customers, many of whom are served by our vast channel network that partners around the world.

The third area is one that, by me being part of the organization that includes services and HP Software, which includes OpenView on our new Mercury acquisition, gives us the prospect of being able to have one type of category pull through another. So we've done a lot of work when we sell servers to sell the storage. Or we sell either product to bring through support. And now, increasingly, we're operationalizing processes, such that when we're advantage services or outsourcing engagement, that that would pull through perhaps, data center consolidation project, which would bring OpenView and many of my products and storage and servers as well.

So, that's what you see there at cross category pull through. We believe we have experienced to date some revenue leakage, is our term around the organization, just opportunities where we just have not capitalized on those account coverage situations. So, very briefly on the Enterprise Server piece, this is obviously the majority of our business overall.

One of the concerns, I think that was voiced early on, five years ago when we created the organization, was, well gee, you see this inevitable shift between industry standards servers -- or X86 as shown in this picture; you know that's going to become more and more a part of your mix, doesn't that have a mix and rate degradation challenge for your business overall. And clearly what's happened is we've gone from about 61% of the business in that category to 67, and really if you add in that Blade, that green piece, you're up to about 73% in X86 systems today.

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You'd have to conclude that that must not be true, because the chart that I showed you earlier showed that our profitability has gotten extremely much better through that same period of time. What it means is, that we've been able to align our costs against this new business model and this new mix. And part of that was a shifting of the R&D. And the other is that we've been able to monetize some of our intellectual property and use and take advantage of a high velocity business model, like the industry standards servers affords us, to pull through some of our software and services as well.

And so, from that perspective we didn't see the X86 shift as something we should avoid, it's something we should embrace and lead. And certainly we have, you see there for over ten years being the market share leader in that category. We're also the leader in the operating environments that we choose to participate in, which is the vast majority, over 90% of the server business, being Windows, Linux, and Unix. A lot of people ask questions over the years about, gee, aren't you worried about Linux taking over Unix and something like that.

We lead in all these categories with Linux in particular. We do not have an innovators dilemma in this regard. We see these trends, we embrace them. In fact, we want to be a first mover in many of these areas, and allow ourselves to figure out how to monetize our value and core services components through in these new emerging categories. And certainly with Blade that I'll talk about in a bit, our revenue is up 47% this year, and this is a key area as we move forward. And I'll talk about that in just a second.

So the storage category, as I mentioned before, it's really a portfolio of products, and sometimes it's very difficult to figure out how we're actually doing when you compare us to the external world of storage. Because we're not like any one storage vendor. About 40% of our business is in near-line or tape. And you see that business is declining in this chart. But it is extremely profitable and as I mentioned before, this an example where consolidated the category, we've gotten a lot of our costs out of this.

It's also an interesting one in that the tape cartridge business leverages the print distribution business for retail from the printing business. So, that's my seventh route to market. We actually have a very substantial business there for consumables here that leverages the consumer part of our company. But the areas that we're really focused on and growing here is the storage area network piece, where we've grown 8% in the high end and 23% in the mid-range of our EVA space outgrowing the competition in this area. This has been a key area of investment as well in the mid-range, a source of where we invest for intellectual property.

And then our software area we made two key acquisitions to augment our data protection strategy in the last year. One is the industry's leading storage resource management platform, FIQ, which is now productized in HP called Storage Essentials. It's a multi-vendor heterogeneous storage resource management platform that we've integrated into our one pane of glass if you will, a common management infrastructure for all storage and servers across our portfolio. And OuterBay is a data management, data resource management archiving solution as well that we're just now starting to ship under the HP brand.

So this, all and all has been an excellent portfolio for us. Last quarter the external results showed that we had [the] low growth, even 1% actually compared to a very strong Q4 of last year. But if you look underneath there, that was largely driven by tape, a difficult compare, and yet it was a record quarter for us inside of ESS. We have talked about the Adaptive Enterprise and the Adaptive infrastructure for a long time inside of HP. I'm not going to go through this whole slide, but believe me --.

But let me tell you about one trend that we see that customers can really resonate with. And that is that the islands of IT were historically servers and storage have been provisioned by application and work load by a department, resulted in a situation where a lot of our systems were sitting there at 15, 20% utilization rates. And that inevitably drove a very high operations cost, and it eventually caused companies to not be able to innovate because there whole IT budget was basically carved up and consumed in maintenance.

So, our adaptive infrastructure strategy goes after that issue and these seven or so -- six pillars down there below, around great products, power and cooling management, security virtualization, automation, are all the enablers that allow us to think about how you provision a data center quite differently.

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And so, as we've moved IT from our high value systems on to volume platforms, it's with an eye toward really achieving this adaptive infrastructure vision, which allows our customers to envision what we call a 'lights out seven by twenty-four next generation data center' which would have these pools of IT resources, managed centrally with way better efficiency in both power cooling operations staff and utilization rates. And also better data protection and security, and at that point you can imagine a lower cost disaster recovery strategies for these integrated data centers.

At HP, Randy Mott, our CIO, yesterday talked about our strategy inside of our own company, employing this technology as we go from 85 data centers worldwide down to six. My last couple of concepts here that I'd like to just talk to you about is around our Blade Systems. When we freed up some money a couple of years ago, we identified Blade Systems as the next big thing. We actually believe that all of the storage, all these server categories growth will be in the Bladed configuration over the next few years, as compared to Pedestal or Rack optimized systems.

The reason why Blades are a big deal is that within our case, a 17 inch rack mountable chassis, you can bring in all the capabilities of X86 servers, Itanium or Integrity servers, storage Blades, all the switches and things you need for both networking and storage are networks, and put them all in one chassis and manage them from a single console. You can also because of our virtual connect strategy, be able to, in a very cost effective way, add or provision new Blades without bringing the overall system down. And you can even re-cable the system because of the virtual connect.

You can see in the lower left hand corner the benefits that we've been able to prove, which are dramatic, and really go after the issues that our customer pinpoints were around as I discussed the Adaptive infrastructure. This category has done extremely well for us. Our biggest challenge over the last four or five months has actually been able to ship them. We have been our factories around the clock at full capacity to be able to build [the new] systems.

It's been a very, very exciting category for us and this chassis, this c-Class and this environment and the software that goes with it, is going to provide the foundation for many years. And our mantra inside of HP is we're going to Blade everything. We're going to Blade our Integrity Servers, we're going to Blade NonStop, we're going to Blade our storage. As an augmented unit for our product line, to go with the standard product line that we've got.

The last one I'll mention briefly, is the investment, is the announcement that we made about three weeks ago around data-center cooling. This is a huge pain point for customers, because many of the data-centers, particularly you can even see it here in Wall Street in the financial services sector of many of your companies, I'm sure have data-centers that simply cannot power or cool the environments. And you can see here that for many our customers, 40% of the total cost of ownership for the data center is tied up in this issue. And by the way, more than half of the energy that goes into a data center goes into the power and cooling and not into the products running the data center itself.

So, anything we can do to reduce the power of the components themselves, and then to be able to optimize the air conditioning flow in your facilities department with the customer, is going to help them achieve some of the goals that they've got about getting all this compute density and storage density inside their data-centers.

This picture that's shown here is an actual thermal mapping of a data-center. And the Dynamic Smart Cooling technology that we announced a couple of weeks ago is really taking the sensors that are within our racks, and integrating them into the HVAC systems at a very smart way inside of a data-center. And in the future we'll actually extend that back to how we automate and provision workloads and we'll move workloads to parts of the data-center, which are actually under utilized and running cooler. So, it's basically extending that whole concept of power management to the whole data-center.

And you can see what we see there in terms of the goals and costs. So, this is a real big -- and this is also something that's great for our services organization as well. As we, in terms of the assessments services coming in and being able to help customers. So, in conclusion, it's an exciting time to be at ESS. It's really about us growing our gross profits and share, getting that balance right.

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We're in a great position to be able to do that, leverage our business model, to bring in high IP and value on top of our really low costs and velocity supply chains. And leveraging HP is a great thing. When you've got a company that's shipping 35 million PCs or PDAs and 54 million printers a year, it gives you some cost of scale and channel economies that are just fabulous for us to leverage off of.

So, with that, let's go to our questions.

QUESTIONS AND ANSWERS

Unidentified Speaker

Great, what I'll do is, I'll kick it off with a few. And then we have a microphone here, so please wait for your microphone and then we'll take questions from the crowd here. So, by the way, on my left is Brian Humphries of HP Investor Relations, who can also contribute quite a bit to Q&A here.

So, Scott, one thing I'd like to talk about a little bit more is your unit strategy, the Itanium gets a lot of debate. So, what -- could you just talk about your commitment to Itanium and the roadmap there, and then is there any change that AMD can scale up into that category as well.

Scott Stallard - Hewlett-Packard - Senior Vice President

That's a good question and this comes up a lot, Ben. Our commitment is to the Integrity platform. We're not talking about Itanium as much as Integrity because it really is a broader offering than the micro-processor from that perspective. And that's where we're going to run our OpenVMS, or NonStop formally Tandem business as well as our HP-UX business. Itanium affords us a set of capabilities from Intel that is particularly good for us and our high availability, highly reliable and very serviceable environments.

It is well with the advent of Montecito this last year, which we're now shifting. We now have the strongest lineup we've had in a long, long time. Intel as well, you can ask them, is very committed to this architecture as well. In fact Paul, Otellini stood on stage with Mark Hurd in March and confirmed that. I think the question you have comparing this ecosystem and set of decisions to like AMD, performance and cost or addressability, kind of like only one dimension in the problem.

I think the migrate customers from these environments, as we've just experienced, moving them from PA-RISC and Alpha's is very expensive proposition, is very disruptive as well for our ISVs and customers. And so, we have no plans to change that and actually see no reason to really do that.

Unidentified Speaker

Okay. Any questions out there? [Bob]?

Unidentified Audience Member

Can you talk about your use of two and half inch drives and if that is a competitive advantage? And also, a little bit about what Quad Core is going to look like this year.

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Scott Stallard - Hewlett-Packard - Senior Vice President

Yes, so the small form factor drives, we've just integrated into our whole lineup. Both entry mass and sandboxes, as well as all the G5s so the Woodcrest product roll for our product line as well the new c-Class Blades. We've got these things everywhere. And if anything, we probably integrated them into our offerings before cost cross over occurred. But we did sell because we didn't want to create a disruption point for our customers. And we sure didn't want to roll these products again.

We introduced 27,000 SKUs last year. Many of them were dependent on this form factor. So, from that perspective, we're happy we made that choice and it's been afforded us -- by the way, we have a product, product guy at the end of the day -- we have [PU] product that can hold 9 terabytes, all right. In fact you even wonder, is that a storage product or a server product. The answer is yes, it's kind of both. And it's really enabled by these small form factor drives, which we find are extremely reliable. and I'm not sure whether we've retrieved cost cross over or not, but it's one of those inevitable things we're glad we're ahead of the curve.

Quad Core, we seen a good uptake on it as we came out with this capability. One of the questions I got about eight times yesterday, is a question you always here, when there's a big product roll like this; like, well gee, with Quad Core, does that mean everybody's going to buy half the number of slots? And I'm not -- I don't subscribe to that theory at all. I think what we're going to find with Quad Core is that, maybe for a given workload you can deploy a given application on fewer cores, and therefore a smaller box.

But, as we virtualize the environments more and more, all that this is going to do is change the cost of computing, which at the end of the day, if we can get the utilization rates up, it's going to open up the ability for customers to deploy even more applications. And so, my experience with this is we've gone from SMP to a single [technical difficulty] cores, is that we're going to continue to see [broader opportunities] technology.

Unidentified Speaker

Yes, as -- [Chuck] has a question up here; I'll sneak one in as the mike's going over. Could you just elaborate a little more on storage, perhaps your EVA in particular? Your growths been pretty good, but the product cycle perhaps is maybe over a year old now. So, what are you going to do to keep that line going, especially as your competition has probably, pretty intense in that area as well, your mid-range storage.

Scott Stallard - Hewlett-Packard - Senior Vice President

Yes, so that is the sweet spot of our storage offering. We have on the [cred] EVA form factor instead of capabilities; we want to use added functionality on that frame. Next year there's a lower cost version, later in the year even than that, towards about 12 months from now.

There's really nothing in the EVA architecture that dates it. In fact, the last product roll was a major, all most a reinvention of the product. We kept the EVA brand because of the strong brand equity that we've got there. The down side is it looks like we didn't change anything, but actually we changed almost everything in it. So the product is very fresh, and this is an area where actually, once again our win rates are extremely high, in fact if anything, a little too high.

And so, we view that competitiveness and growth in the mid range stand space for us is really about our go to market plan more than our products. It's getting our account management teams, our specialization up, getting our channel programs lined up with us.

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Unidentified Speaker

But, I mean, it's still with what you see a significant double digit grower --?

Scott Stallard - *Hewlett-Packard - Senior Vice President*

Oh absolutely. Absolutely. This again, this one was 23% growth for us last year and double, over 20% the year before.

Unidentified Speaker Ben

Yes. Chuck?

Unidentified Audience Member

First off, can you touch on the Integrity strength, the 84%. Was that year or quarter? Was that for the full year or just for the quarter?

Scott Stallard - *Hewlett-Packard - Senior Vice President*

That was the full year.

Unidentified Audience Member

And, can you touch on what's driving that.

Scott Stallard - *Hewlett-Packard - Senior Vice President*

Well, what's driving that growth rate is the fact that we've shifted all of our, as much as we can, PA-RISC and Alpha business over to that platform. And what enabled the switchover; we actually reached the tipping point on an application availability. We poured another 200 and something million into ISVs and applications that we announced last March, to finish the ports of all our key ISVs. Including almost all the completer apps the customers need. So, application availability caused the tipping point.

And now as Montecito's coming on board, we've eliminated the performance gap we that we had on the previous generation. And, in addition, our account coverage got better. So, account coverage application availability and the performance gap that we had. So, those were the three things that this, you can see this, it's really flipped.

Unidentified Audience Member

And a second question. Microsoft's Vista for servers, when it comes out, is going to have, it sounds like, some challenges because the Sequel Server 2005 needs to be upgraded for Service Pack. You got Visual Studio needs another service pack that's not even out until after it's out. What kind of impact did that have on server based sales until Microsoft's able to get all their applications queued up to work together?

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Scott Stallard - Hewlett-Packard - Senior Vice President

Yes, I haven't seen that much being a driver in our forecast. The bigger forecast impact for us is Exchange. So the big Exchange migration, the chance to come in and Blade the environment and consolidate these data centers around e-mail, more than the Vista roll that you mentioned.

Unidentified Speaker

Some in the back there. As we're getting the mike to those guys, anything you just want to touch on with regards to Mark Hurd's focus on the P&L that you think is sustainable. That -- your margin was a big surprise last quarter. I mean, going forward with Mark's influence and your own, how should we look at your profitability? Maybe just a few more examples that give us confidence this progress will continue.

Scott Stallard - Hewlett-Packard - Senior Vice President

Well, as we were talking on the way in, Mark is definitely -- first of all I've been at HP 32 years and he's -- it's great to have Mark as part of our company. He is our, he is an outstanding leader. In fact, with him I see a lot of Bill and Dave, who I was lucky enough to know. In terms of both the core values as well as operational style is extremely refreshing and welcomed, by the way to employees and customers alike from that perspective.

His focus on the big three is consistent -- persistent, he's focused on cost and efficiencies. And their like, everybody gets that but what I think people miss, is that the reason we're focused on that is that frees up capital to invest on growth. And so more of our meetings are, how are you going to reinvest the savings we've made in IT in real estate?

What are we going to do with our balance sheet for a smart M&A to augment our product lines and our offerings, so that we can grow faster, more profitably and still let our customers more? That's like eight meetings, and -- two of the other ones. So, that's where we're spending our time and we actually spent a lot of time on that yesterday, from that prospectus. So, we really work all angles of grow, efficiency and capital, angles and their strategy. And our goal, as we stated yesterday, is to be the leading IT infrastructure company in the world.

Unidentified Speaker

Great. There were two questions in the back, [let's see] if we can get those addressed and then move back up to the front. We got about ten minutes.

Unidentified Audience Member

Okay, Scott. Two questions back to industry standard servers, if I could. The first is, for a long time, you guys had a pretty wide open playing field, or almost wide open playing field on Opteron, but Dell has embraced it and IBM's getting more enthusiastic about it. So, how has that changed the pricing environment and your sales momentum and how do you think it will?

And then the second question is, Intel introduce Woodcrest a few months ago. I'm wondering how that's changing what you guys are quoting or what you're seeing, either in customer decision making processes or what they're specifying?

Scott Stallard - Hewlett-Packard - Senior Vice President

The way we -- we did definitely enjoy a window of time there where Opteron was a considerable competitive advantage. And by the way, I think it, well -- it's not very speculative to say that I think it made Intel very much stronger company as well. I think

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the Woodcrest offering, this is a direct response to needing to have a more competitive offering. And now they do. I mean Woodcrest is an excellent product. And now, it's a two horse race, which is what we wanted anyway. I think it's what customers want. That's what you should want, is that there's competition throughout the value chain here for everybody delivering the best value to their customers, and giving them that choice.

So we did have a fee run at it. And we used that largely to gain share and we did. We did extremely well in that category. As others have followed suit, inevitably, it's been all over the map whether they've used their AMD products for, to grab share, or to boost -- I can't find a trend here yet to figure out what they're going to do. But, I spend more time worrying about customers than I do watching pricing stuff like that.

We have a street price and we have a scenario where we can get into bids for larger accounts, where we know our cost structure and we price what we need to do to win deals as we can. And whether is AMD or Intel or Integrity for that matter, that's what we're positioned to do. That's why we want to have a very effective cost structure. It's way beyond the microprocessor, from that perspective.

Unidentified Audience Member

I have a question just in the back here. Can you talk about HP's InfiniBand strategy, and are you seeing any traction for InfiniBand outside of the HPC environment?

Scott Stallard - Hewlett-Packard - Senior Vice President

Not that I've thought about in awhile. Actually, so I'm probably not a good expert on InfiniBand for that environment. It does, it is part of our offering and our infrastructure. I have not seen it be topical in anything I've looked at in six months.

Unidentified Audience Member

Just what percentage of the restructuring costs were associated with the ESS division over the last few years?

Scott Stallard - Hewlett-Packard - Senior Vice President

I'm sorry, can you --?

Unidentified Audience Member

On the restructuring charges, what is associated with ESS?

Scott Stallard - Hewlett-Packard - Senior Vice President

I don't know. We don't break that out, [do we]?

Brian Humphries - Hewlett-Packard - VP Investor Relations

No, we don't break it out. But I'll try and position as follows. We took a charge of about 1.7 billion in July '05. We said that would save us approximately \$2 billion, of which about 300 million was pension related, and 1.7 was work force reductions. Of the work force reductions, about 50% of those were backend costs, including IT, finance marketing, etc. Of which, those costs tend to be allocated down to segments in the form of [ABC] costing, headcount, floor space, gross margin dollars, etc.

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So, ESS just given some of the headcount propensity, will get their fair share of that, but as Scott has shown in the slide, the five year profitability improvement suggests that the restructuring benefits were certainly one factor, but a small factor over the last five years. A lot of this [Lynette] probably would have benefited more, just given the headcount propensity of services, not just from a risk structuring cost of headcount reduction, but also from a pension change.

Unidentified Speaker

[inaudible] go ahead.

Unidentified Audience Member

Scott, I just wanted to follow-up to some degree on the last question. You showed the slide earlier, ESS's operating margin improvement over the last two or three, four years. And in your presentation you talked about some of the things that you guys did to produce that improvement. Just curious, if you could kind of rerun through those various items, and talk about how much more legs you have on any of those, if at all? And where future margin and operating margin is likely to come? If you could help us with that.

Scott Stallard - Hewlett-Packard - Senior Vice President

Yes, I think of all of those, there's still legs in all of them --.

Unidentified Audience Member

Could you just repeat though, what some of those main metrics or aspects were that resulted in the margin -- when you talk about R&D spending, shipping that, and some of that?

Scott Stallard - Hewlett-Packard - Senior Vice President

Right, so, again the big levers were, the first one which is very operational is around discount management. And it's -- in a very complex global organization, trying to find the right price, to find the sweet spot in gross margin dollar contribution is science and art, right? To get those elasticity models just right. I still think that we could work there to do a better job, both at the product and portfolio level to improve that. And that's something I think is true across most big enterprises. So we're working on that.

I think there's more work to be done in warranty and unit cost delivery from services. I think there's more work that we can do in making sure our R&Ds applied to things that are going to grow, that are at margin and not immature or declining businesses. Without de-committing road maps or causing anything to happen like that. I think we can continue to attach more product and services across HP, given that we're in one account to bring more in. So, like for every one of these, I think there's legs for all of [them].

Brian Humphries - Hewlett-Packard - VP Investor Relations

Just to quantify this, we closed fiscal '06 with 8.4% operating margin in Scott's business, significantly, up year-over-year. We gave guidance for FY08 of 9 to 10% operating margin.

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Unidentified Audience Member

And where do you think most of that incremental margin is coming from? Is it all of the portfolio of issues you talked about there, or is it just one or two particular areas that's going to contribute the most?

Scott Stallard - *Hewlett-Packard - Senior Vice President*

It, they're all contributing.

Unidentified Audience Member

Scott, I wanted to ask you, you mentioned that part of the margin improvement comes from pulling through other attached, services for example. So, if you guys -- do you guys make the service sale and get credit for that, or do you have to pull in somebody from the services side of HP and to do the sale and they get credit for it?

Scott Stallard - *Hewlett-Packard - Senior Vice President*

At the segment level, that goes to HP Services, but if you look at the compensation systems we've created for both direct and indirect, we've blurred the lines of who gets paid and gets quoted so as to create the cash scenario to occur. So, for instance, services will pay for a specialist in my camp to pull through support, and similarly I will pay for a pursuit team in managed services to pull through my products. So, that's how we've broken down some of the barriers across the reporting segment to get this attach rate up.

Unidentified Speaker

My watch shows we got three minutes, at least. So, I'll ask one more and then if anybody else has one, we might have time for that. With regard to your channel strategy, and whatnot, can you talk about direct versus in-direct? And you guys restructured your channel practices under Mark and how's that going, is everything completely done and now optimized for profitability?

Scott Stallard - *Hewlett-Packard - Senior Vice President*

Yes, one of the great things that's happened in this last year, we did to your point change a lot of our channel bonus compensation around our attach program. Mark was very public, up-front in one of his first meetings in Las Vegas, he said we want to -- we need channel partners to reach every, to reach all the customers that we want to reach. And we want to reward those partners that bring more HP content than those who don't.

And so, we created a set of programs to go back to the attach example called 'attach plus' that have worked incredibly well. And we have had seen dramatic improvements in channel loyalty pull through attach rates and margin expansion. We're extending those this year to include some of the storage connections as well. So, that is our new emphasis for our fiscal year '07.

In terms of the channel mix between direct and in-direct, we will, to achieve our goals with our scope and scale, we need to do business every way that our customers choose to do business. Which will include both a direct and in-direct motion. We realistically though, when you think about the total addressable market that we want to go after, we cannot touch all those customers.

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Unidentified Speaker

I mean, I don't know if you guys disclosed, Brian or Scott, I mean, is it half or there's no --

Brian Humphries - *Hewlett-Packard - VP Investor Relations*

We don't disclose it.

Unidentified Speaker

[Dave]?

Unidentified Audience Member

Last quarter it sounds like storage results were a little below your expectations, and it sounds like your saying it's not a product issue. And I'm just curious, kind of specifically, about then what can you do on the sales side or what are you doing to try and improve those results? And I had one more, if possible.

Scott Stallard - *Hewlett-Packard - Senior Vice President*

Yes, in particular, we had some fall -- some short falls in tape that were very geographic, in fact they were almost country specific. And so, it was very clear what we had to go do. One was direct, and one was in-direct issue that we had. On the storage area network side, I think a lot of that was set up by a difficult compare from last year, so the [OpEx] were not good, but it was our record quarter in storage. From both a revenue and operating profits perspective.

So, that said, we still have work to do. And when Mark and [inaudible] both talked about, this is an area we want to see even more coverage, more specialization and higher growth. It is not a product issue, it not a pricing issue.

Unidentified Audience Member

So, do you feel like you've got the resources then you need in place on storage? I know you guys have done a lot of work over the last year there. And does it just come down to consistency of execution, or do you still need more things -- people trained specialists, all of that?

Scott Stallard - *Hewlett-Packard - Senior Vice President*

I think we are, I think a lot of the gaps that we are closing continue to be in the specialty area. I think one of the areas that we experienced was to the extent to which a [generalist] who might cover a lot of storage and a lot of servers, what will happen at the end of a quarter when their going to make their numbers and what they do. And so a lot of it has to do with what they're trained in, alright.

And you see this more in smaller geographies where you have more people trying to cover multi categories, and the lesson learned and the thing we're continuing to fix is to make sure we that we get enough specialty bandwidth to be able to close the storage transaction. Which in many cases is a longer sales cycle and actually may be calling on a different person in the account for that matter. Or a different channel partner. So, it's just really recognized that end to end chain has to be attached. So, that's why I say it's very country specific and those plans are in place to augment that.

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Unidentified Speaker

Now we're truly out of time. So, thank you so much, Scott and Brian for being here and the HP team. And great job and we look forward to having you again next year. Thanks a lot.

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