

FINAL TRANSCRIPT

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HPQ - Q3 2008 Hewlett-Packard Earnings Conference Call

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PRESENTATION

Operator

Good day ladies and gentlemen and welcome the third-quarter 2008 Hewlett-Packard earnings conference call. My name is Nikita and it will be my pleasure to assist you today. At this time all participants are in listen-only mode. We will be facilitating a question-and-answer session towards the end of today's conference (OPERATOR INSTRUCTIONS)

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As a reminder, this conference is being recorded for replay purposes. I would now like to introduce your host for today's call, Mr. Jim Burns, Vice President of Investor Relations. Please proceed sir.

Jim Burns - *Hewlett-Packard - VP, IR*

Thanks Nikita. Good afternoon and welcome to our third-quarter earnings conference call with Chairman and CEO, Mark Hurd; and CFO, Cathie Lesjak. This call is being webcast live. A replay of the webcast will be available shortly after the call for approximately one year.

Some information provided during this call may include forward-looking statements that are based on certain assumptions and are subject to a number of risks and uncertainties and actual future results may vary materially. Please refer to the risks described in HP's SEC reports including our Form 10-Q for the fiscal quarter ended April 30, 2008.

The financial information discussed in connection with this call including tax related items reflects estimates based on information available at this time and could differ materially from the amount ultimately reported in HP's Form 10-Q for the fiscal quarter ended July 31, 2008. Earnings, operating margins and similar items at the Company level are sometimes expressed on a non-GAAP basis and have been adjusted to exclude certain items including amortization of purchased intangibles and restructuring charges.

The comparable GAAP financial information and a reconciliation of non-GAAP amounts to GAAP are included in the table and in the third quarter earnings slide presentation accompanying today's earnings release, both of which are available on the HP investor relations webpage at HP.com. Before I hand the call over to Mark, I wanted to make a few comments regarding the pending acquisition of EDS.

We anticipate that the acquisition of EDS will close later this month. Under this assumption, HP plans to hold a securities analyst meeting on September 15 where Mark Hurd, Cathie Lesjak and other executives from PSG and EDS will discuss HP's opportunities in the enterprise market including actions we will take and the expected financial impact to HP of the EDS acquisition in Q4 and upcoming periods. The meeting will be webcast live and available on the HP investor relations webpage at HP.com.

I'll now turn the call over to Mark with a final reminder to please refrain from asking multi-part questions or clarifications during the Q&A.

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

Good afternoon and thank you for joining us. Hewlett-Packard delivered another strong quarter. These results further demonstrate the benefits of our global reach, diverse customer base and broad portfolio of products and services.

In addition as I have said many times before, our numerous cost initiatives continue to provide us with the opportunity to invest for long-term market leadership while also generating near-term operate leverage. HP is unique in the variety of IT customers it serves.

In emerging markets, new customers are coming online everyday to create, view and print content and are helping enterprises scale and modernize their infrastructure to process and to store this data. In developed markets, CIOs are investing to cope with the explosive growth in digital content and seeking projects which improve their cost structure such as virtualization, data center automation and outsourcing.

Companies are reexamining their IT needs and increasingly moving toward open systems and [standard-space] technologies. We believe that we are well positioned to capitalize on these trends as reflected in our strong results this quarter.

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Our cost savings programs allow us to invest in strategic areas such as salesforce hiring, software and graphic arts while expanding our margins at the same time. As I mentioned to you last quarter, while we become more efficient our cost initiatives are significant and ongoing and we expect them to create additional leverage in our operating model.

In fact, we expect that our overhead costs which includes IT, real estate and corporate support functions will decline more in dollars year-over-year in 2009 than they have in either 2008 or 2007. While we primarily want to focus this call on our quarterly results and fourth quarter outlook, let me comment briefly on EDS.

The [planning] is going well and we are confident in the benefits of this business combination will bring to customers, partners and to shareholders. We have over 500 HP and EDS people dedicated full-time to the integration team.

The feedback from the vast majority of the customers that I talk to continues to be extremely positive as they contemplate the power of HP's innovation coupled with EDS's scaled service business. I look forward to sharing more details with you at our September 15 meeting.

In summary, I'm very pleased with our results. As is true with every quarter, some numbers are strong and others indicate where we have more work to do. In the end, our diverse business model, disciplined execution, and significant cost saving opportunities have enabled us to consistently produce strong business performance. With that, I'll turn it over to Kathy who will review the numbers for the quarter.

Cathie Lesjak - Hewlett-Packard - CFO

Thanks Mark and good afternoon everyone. Revenue for the third quarter totaled \$28 billion, up 10% year-over-year or up 5% in constant currency. Looking at revenue by geography, the Americas increased 4%, EMEA was up 16% and Asia-Pacific increased 14%.

We generated 68% of our total revenue from outside of the United States. Third quarter gross margin was 24.2%, down 30 basis points compared to a year ago. This decrease in gross margin was driven by both a more normalized commodity pricing environment and increased mix of personal systems which were partially offset by strength in services and software.

Non-GAAP operating expenses for the quarter were \$4 billion dollars or 14.4% of revenue, down 110 basis points from 15.5% a year ago. Adjusting for currency, total expenses declined year-over-year as we continue to maintain expense discipline even while investing in sales and go-to-market resources and absorbing acquisitions.

Non-GAAP operating profit increased 20% to \$2.7 billion or 9.8% of revenue. Non-GAAP OI&E yielded income of \$23 million in the third quarter. Our non-GAAP tax rate was 21% in Q3.

Non-GAAP EPS was \$0.86 representing a 21% increase from the prior year quarter. GAAP EPS was also up 21% to \$0.80 which included \$161 million or \$0.06 per share in after-tax adjustments primarily related to the amortization of purchased intangibles that were excluded from our non-GAAP results.

Looking at the performance by business segment, personal systems continued to post solid results maintaining the number one worldwide market share position in calendar Q2 with revenue growing 15% or \$1.4 billion to \$10.3 billion. Total units in shipments increased 20% with strong growth of 37% in notebooks.

PSG maintained balance growth across its businesses with consumer client revenue up 17% and commercial client revenue up 15%. We outgrew the market for the twelfth consecutive quarter. Growing in emerging markets continued highlighted by triple digit growth in Russia.

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Developed economies posted solid results including renewed growth in the United States. We are excited about our strong fall lineup with innovative products such as our second generation TouchSmart PC and the HP Mini-Note.

PSG's operating profit for the quarter was \$587 million or 5.7% of revenue down 10 basis points versus the prior year reflecting a more normalized commodity pricing environment. I am pleased with the continued execution within PSG.

In Imaging and Printing we expect to gain share in calendar Q2 despite a tough market. For the quarter, revenue was up 3% to \$7 billion led by supplies growth of 11%.

Commercial hardware revenue declined 5% year-on-year and the consumer hardware revenue declined 14%. Excluding cameras, consumer hardware revenue declined 8%. Segment operating profit increased 50 basis points from the prior year to 15% as strong supplies growth and cost actions were partially offset by discounting.

We shipped 13 million printers in the third quarter, a decrease of 2% year-on-year. Consumer printer hardware units were flat and commercial printer hardware units were down 9% year-on-year.

In the commercial business, we are seeing strong customer adoption of our Indigo press products. High-volume, digital color printing is an increasing source of growth for the global graphic arts industry and we are well positioned to lead in this market.

In May, we participated in the (inaudible) industry trade show where orders on the floor exceeded our high expectations. Highlights included the sale of over 30 HP Indigo presses to a leading commercial print company to meet the growing demand for photo book and digitally printed direct marketing materials.

Within IPG we are focused on reducing our cost with ongoing initiatives to improve supply chain efficiency and lower product costs. We are investing these savings in targeted growth areas including the enterprise and graphic arts. We will continue to be prudent in our pursuit of lower end units and will balance growth and profitability to drive long-term results.

Moving onto technology solutions group, Enterprise Storage and Servers revenue was \$4.7 billion up 5% year-over-year led by strong ESS blade revenue growth of 66%. Enterprise Storage and Service posted solid third quarter operating profit of \$544 million or 11.5% of revenue up 30 basis points year-on-year.

Within ESS, storage revenue growth accelerated to 16% driven by 19% growth in both our MSA and EVA [San] products. Over the last few quarters we have launched new products across the portfolio and enhanced our go-to-market model, Both Of which are helping to improve our storage results.

Turning to our server businesses, Business Critical Systems revenue grew 2% with Integrity revenue increasing 18%. In Industry Standard Service we executed better this quarter than last with revenue up 2% year-on-year and units up 13%. Customers are increasingly implementing HP's blade system to expand their IT infrastructure and this quarter we shipped our millionth blade.

HP Services had a strong quarter with revenue growth of 14% over the prior year period. We saw topline strength in every business with technology services and consulting and integration revenue up 13% year-over-year and outsourcing revenue up 18%.

Within technology services we're seeing better penetration rates as we attach more maintenance services to our hardware sales. In our outsourcing business we're winning competitive bids in a number of industries including a large contract with a global telco provider. In our consulting business, we've seen solid growth in the public sector.

Operating profit for the quarter was \$574 million or 12.1% of revenue up 2.1 percentage points year-over-year. The contribution of strong revenue performance from technology services combined with the progress we're making to improve our delivery processes drove the expanded operating margins.

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HP Software delivered another good quarter with revenue of \$781 million up 29% from the prior year. BTO maintained its momentum with 32% year-over-year growth as large enterprise customers increasingly adopt our software management solutions to help maximize the value of their IT infrastructure.

This success is reflected in the 39% year-over-year growth in large deals. Other software which includes OpenCall, business intelligence and information management grew 17% due to the strength of the information management business.

Software reported operating profit of \$122 million or 15.6% of revenue up from \$51 million in the prior year. Strong operating performance within BTO was partially offset by integration costs and investments in business intelligence.

HP Financial Services had revenue of \$680 million up 17% year-over-year and generated operating margin of 7.5%. We are encouraged with the growth in our core financing volume and portfolio of assets over the last several quarters as well as the performance in end of lease renewals and equipment sales.

Moving now to the balance sheet. HP owned inventory ended Q3 at 35 days of supply, down three days compared with a year ago. With regards to channel inventory, we ended the quarter with ESS, PSG and IPG each flat year-over-year.

Days sales outstanding increased to 44 days in Q3 from 42 days one year ago. Days payable was 59 days up five days year-over-year.

Next, property plant and equipment was up \$492 million year-over-year and down 40 basis points as a percentage of revenue. Gross CapEx was \$651 million down 13% from the prior year period.

On a net basis, CapEx was \$573 million up 5% year-over-year. Increased capital expenditures were primarily related to growth in our leasing and outsourcing businesses.

Onto our cash flow and cash balance. Cash flow from operations was \$3.4 billion for the quarter and free cash flow was \$2.8 billion. We are well ahead of our cash flow goals for the year with year-to-date free cash flow of \$9.6 billion up 125%.

During the quarter, we spent \$1.6 billion on share repurchases representing approximately 34 million shares. At the end of the quarter we had roughly \$3 billion remaining in the current share repurchase authorization.

Finally, we paid our normal quarterly dividend totaling \$197 million. We ended the quarter with a strong balance sheet including total gross cash of \$14.9 billion and net cash of \$4.8 billion.

Now looking ahead to our outlook for the fourth quarter, we expect to close the EDS acquisition by the end of the month and this will result in a substantial cash usage for Q4. As we announced earlier in the call, with this timing we will hold a security analyst meeting on September 15 and will discuss the financial impact to HP of the EDS acquisition of the time. With that in mind, I will focus our comments today on the outlook for the Company excluding the impact of the EDS acquisition.

Given our significant international exposure, our results may be favorably or unfavorably impacted by currency. As we have seen in the last few weeks, in particular currency rates can at times be volatile.

For Q4, we expect revenue of approximately \$30.2 to \$30.3 billion. This outlook is based on currency rates from the beginning of August. If the dollar stays at current levels, we may experience some downward pressure on revenue but would still expect a comparable constant currency growth rate.

Regarding earnings, there are few variables to keep in mind. We expect the component pricing environment to be similar to Q3 and more in line with normal historical patterns. In addition, we estimate non-GAAP OI&E to be approximately 0 due to lower interest income and higher cost of currency hedging. Finally, we expect to continue to repurchase shares in the coming quarters with a modest decline in weighted average shares outstanding in the fourth quarter.

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With all that in mind, we expect Q4 '08 non-GAAP EPS in the range of \$1.01 to \$1.03. We're focused on those elements that we can control and have a lot of confidence in our ability to execute and deliver these bottom-line results. We will now open the call up for your questions.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS) Bill Shope, Credit Suisse.

Bill Shope - Credit Suisse - Analyst

Can you guys comments on what you're seeing with ASP and IPG? Is this really all pricing related or is there a mix component as well?

Mark Hurd - Hewlett-Packard - Chairman and CEO

ASP's and IPG, we're pretty stable sequentially. So we didn't see a lot of change in ASP's during the quarter.

Bill Shope - Credit Suisse - Analyst

On a year-on-year basis are you're seeing -- is this more mix shift? Is it pricing? And that's what I am getting at.

Mark Hurd - Hewlett-Packard - Chairman and CEO

So it depends on -- it's a little bit -- depends a little bit on what segment you're talking about because there's a difference in some of the low-end categories versus some of the high-end categories, difference in MFP's versus single function; all that kind of stuff that you know so well. So I mean at the end of the day though on average if you take everything when you look at ASP's over the last rolling eight quarters, there has been not been a dramatic ASP change.

Bill Shope - Credit Suisse - Analyst

Not to ask too many questions here but just to make sure I'm not misunderstanding, I thought I had heard on the commentary that some of the supplies upside was countered by discounting. Was that not discounting on hardware then?

Cathie Lesjak - Hewlett-Packard - CFO

We did see some discounting on hardware on a year-on-year basis the ARU's were down about 10% and that's definitely offsetting the mix of supplies.

Bill Shope - Credit Suisse - Analyst

I see. Okay, thanks for the clarification.

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Mark Hurd - Hewlett-Packard - Chairman and CEO

Thank you.

Operator

Richard Gardner, Citigroup.

Richard Gardner - Citigroup - Analyst

Cathie and Mark, I was just hoping that you could talk about the supplies strength, the exhilaration that you saw in year-over-year supplies growth despite the fact that unit shipments of hardware were relatively weak in the quarter. Could you talk about how much of that is coming from your focus on placements, how much is coming from traction that you might be realizing with some of the new products in the portfolio like Edgeline?

How much is coming from kiosks and so forth? Just any more color you could provide would be great. I know you have been talking about a de-coupling between printer unit growth and supplies growth. This quarter it seems like it's a pretty good example of that. But I would love to get more color.

Mark Hurd - Hewlett-Packard - Chairman and CEO

I will start. Again, to your point, Rich, is right on. It has a lot more to do with the kind of units we place than how many units we place. So graphics of course is a strong story for us in growth. It's also a strong growth in supplies for us. And obviously we're interested in continuing to grow that segment because of the contribution it can make to the overall supplies story.

So that's really what we're trying to do and in some reasons that's why when you see our unit growth -- remember our negative two unit growth is affected also by our movement in appliances. So that takes a point of unit growth away and the rest of it is us trying to be particular about what units we really try to place in what segments that will have a strong connect right on the supplies side.

Cathie Lesjak - Hewlett-Packard - CFO

In terms of supplies growth, we still see long-term sustainable growth is going to be in the mid to high-single digits. So in any particular quarter we may be higher than that or lower than that.

If you turn to this particular quarter, there are a couple of things going on in the 11% that I think we should point out. The first one is that we have more currency impact this quarter in supplies than we typically do because we did not drop prices on supplies in Europe given some of the cost pressures we're seeing in supplies cost of sales.

And we also had a bit of a sell-in from the channel as the channel stalked ahead of the price increase that we announced in Q3 but will be effective in Q4. So there are some additional bumps (inaudible) as a result of that.

Mark Hurd - Hewlett-Packard - Chairman and CEO

So I wouldn't -- I think to Cathie's point, Rich, we think our model for supplies is the same model we told you all along. So while you'll see some volatility here or are there, in the quarter we had pressure on costs and that price increase that's going through now was not reflected in the quarter.

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So you saw some of that sellout as it related to that but again remember for us, the long-term model is roughly the model we've told you all along. That's the way I would be thinking about it, Rich.

Richard Gardner - Citigroup - Analyst

Okay great. Thank you.

Operator

Kathryn Huberty, Morgan Stanley.

Kathryn Huberty - Morgan Stanley - Analyst

In light of continued execution especially on cash flow, why not repurchase more shares in the quarter?

Cathie Lesjak - Hewlett-Packard - CFO

So we have obviously a big cash outflow coming up in Q4 as when we will close the EDS acquisition. And so that's really what's moderating our share repurchases.

Kathryn Huberty - Morgan Stanley - Analyst

So is 1.5 to \$2 billion the right range to think about over the next couple of quarters?

Mark Hurd - Hewlett-Packard - Chairman and CEO

Again, we're probably not going to give you a number. I think that we're going to be active in our shares at a point that makes sense. Obviously as I'm sure this is referencing to our cash flow and we had very strong cash flow from operations.

We for the year generated more cash flow from operations than the first three quarters than roughly we did for the entire 2007 year. So we do have choice points and we're going to be active in our shares. So there's no doubt about that.

Kathryn Huberty - Morgan Stanley - Analyst

Okay, thanks. Congrats on the quarter.

Mark Hurd - Hewlett-Packard - Chairman and CEO

Thanks, Katy, I appreciate it.

Operator

Ben Reitzes, Lehman Brothers.

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Ben Reitzes - UBS - Analyst

Mark, you reaccelerated in the US. Obviously that had previously been a concern voiced by some. You reaccelerated there. Can you talk about what happened?

And also in light of Cathie's comments that you had a lot of confidence you can hit your guidance even though currency may fluctuate, could you just talk about where the US sits in that? And obviously you were able to maintain and even raise guidance despite some concerns. So maybe where the US plays in that going into the next quarter as well?

Mark Hurd - Hewlett-Packard - Chairman and CEO

I mean as always I see there's all kinds of concerns about various different things. But I mean at the end of the day for us the big deal is to execute. And we feel very good about our position in many markets.

When you look at the enterprise in the US from a storage perspective, from a software perspective, from a services perspective, from a blades perspective, this was a really strong quarter for us. I don't think I would extrapolate it to necessarily that we're seeing any change in market dynamics as much as what we're seeing is the fact that we think we're executing within the hand that we've got available to execute with.

So I think that's what we talk about in the US. There are people as I mentioned in my opening comments, a lot of pressure on CIOs that are dealing with a lot of infrastructure that has to be changed out as they modernize their business and they've got to make changes and we think we've got a very attractive portfolio for them. Now to your point on currency, it's important to remember in currency, currency is a very mixed bag.

Inside currency you've got multiple dynamics. You've got deferred revenue that comes off as part of it. That actually is a good guy for us because you book deferred revenue at the rate that when you get and your costs go down as the euro goes down or any other currency you want to insert here.

You've got products (inaudible) -- and I think we've talked about this before -- that moves through the channel or moves through the distribution process at light speed that you never really get any margins sticking to your fingers out of that. And then you get backlog that does get affected and then obviously we have Cathie and the treasury group's got hedging strategies that are used as well.

So you have to -- I don't mean to go into too much detail but there's a lot of stuff you've got to bring together to do it. I think to Cathie's point, we are very confident in our EPS range that we gave today.

Ben Reitzes - UBS - Analyst

And net-net the US should continue the trends that you're seeing to get you there?

Mark Hurd - Hewlett-Packard - Chairman and CEO

We like to think so. I mean we think that we're doing well in the market today and we think that it helps for us the fact that we have got a very diverse portfolio and it's diverse by market, it's diverse by segment and it's diverse by product line. And the mix of those things helps us tremendously in terms of how we decide to invest our money in a quarter in what market in what segment.

One of the blessings I think for us -- it could be a curse depending on how you view it -- is that everybody wants to look at every single segment every single quarter for their optimal performance. And the reality is we do at times turn this up higher and

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turn this one down lower because of what we see in the market. And the result gives us an opportunity to we think have a pretty strong integrated story overall.

So one more time -- I think you asked a simple question. I think we like the position we're in and we think we are going to be able to execute with the range we gave you.

Operator

Shannon Cross, Cross Research.

Shannon Cross - *Cross Research - Analyst*

Yes, just a question, Mark. If you can talk a little bit about how you're thinking about going after certain market segments and geographies within different products. How aggressive are you thinking about being with price? I know we've seen some of your competitors be pretty aggressive. And then also how you sort of think about the trade off of margin given a relatively weak end market. Thanks.

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

It's a broad question, right? It could keep us on the line for a while. I think we try to take advantage of things that makes sense. It would not be normal behavior for us to chase share for the sake of just simply chasing share. It is just not how we choose to go.

That said, we try to look at things that have long-term benefits for HP, long-term benefits for our shareholders. And if it's in the context of that view taking share is important, then we will be more aggressive. So for example, let's take IPG.

When we see very low-end units that we believe have very low, long-term contract rates of supplies and we see an ultra aggressive pricing environment, we may choose for a period of time not to compete and reinvest those dollars in some other part of the market either, Shannon, in IPG or some other place in the Company. So I would bring that up to you as the sense that we try to optimize our portfolio and back to Ben's question, the breadth of that portfolio and the number of markets that we can compete in gives us a lot of options.

So that's how we try to think about it. We try to do it in the best way we can. I'll give you an example to the other side. We see a continual trend in the move towards wireless printers. You look at a home today, instead of having a printer wired through every desktop PC, you now see many families integrating into one printer or two printers that are networked around the home. We had over 150% growth in our wireless printer category this quarter.

In addition, we have a very strong market position in wireless printers and a very strong product lineup. And because of the configurations of those printers being more robust because they're replacing more printers, they have a very high connect rate. Therefore, we would be quite aggressive in pursuing that market segment in a way that we think makes sense. That we would differentiate from a very, very low-end laser with a very low-end connect rate in a single function world that probably wouldn't bring us much long-term value.

Operator

Tony Sacconaghi, Sanford Bernstein.

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Toni Sacconaghi - Sanford C. Bernstein & Company, Inc. - Analyst

Cathie, I just wanted to follow-up on your comments that your guidance for next quarter was based on currency rates as of the beginning of August. The dollar has depreciated 5.6% from August 1 to August 15 versus the euro. So I guess the question is why wouldn't you provide revenue guidance based on spot rates as of yesterday for example? And given current spot rates, are you still confident you can do 30.2 to \$30.3 billion in revenue pre-EDS in Q4?

Cathie Lesjak - Hewlett-Packard - CFO

So, Tony, what I said my comments and I'll stick with them and that is that if the currency or the dollar remains where it is today there will be downward pressure on our revenue but that we will be able to come in in our EPS range; so growing EPS 17 to 20% if you look at that range.

And the reason to not -- we would have to be updating our forecast or our guidance basically daily depending on what the spot rate is. So we have a normal process in which we look at the rates at the beginning of the month in which we're going to announce our earnings and that is the rate we use to drive our guidance.

And I think you saw we had a similar type of issue although it was on a weaker dollar as opposed to a stronger dollar. I believe it was into one where we went through the same thing. It's just too hard to call what the currency rate is going to actually be in the quarter. So what we prefer to do is let you know what our assumptions are, let you know what our tailwinds and headwinds are so that you can then make your own assessment on what the currency is going to do.

Mark Hurd - Hewlett-Packard - Chairman and CEO

One more thing, it's Mark. You would not -- the spot rate, the way you described it and I understand the question, would not in and of itself give you that answer either because you have to look at the factors I described in a question earlier. So you have got a set of deferred revenues that we have to bake into the model. We have a set of hedges to bake into the model.

So our process is to rollup what we do in our normal flow or all of our mechanics are geared that way. And so that's why we have to do that one time the way we do it because to Cathie's point we wouldn't just be updating our forecast everyday for the spot rate, we would have to update our forecast everyday for all of those factors. Now that said, EPS range we gave you is sort of a currency agnostic EPS range and currency will move around as it does and will see what happens.

Operator

David Bailey, Goldman Sachs.

David Bailey - Goldman Sachs - Analyst

Your sequential revenue growth at the midpoint of your October quarter target range, though higher than where the street is right now is still below your normal quarter-over-quarter growth for Q4. Are there any particular geographies or product areas that are driving that?

Cathie Lesjak - Hewlett-Packard - CFO

I don't think we would call up anything specific other than the fact that there's still a lot of economic uncertainty out there. Now we executed much better in Q3 but the macro demand environment didn't change that dramatically. So there's still from our perspective a lot of uncertainty.

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You know us. We like to plan our revenue and then drive our cost structure off of that. So we tend to the conservative. If in fact revenue is better than that, then you'd see some upside. Otherwise, we would stick with the fact that we've got a good forecast out there of 30.2 to \$30.3 billion in US dollars.

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

I think, David, we have also been getting a bit more linear as we have gone through time as well. So when you look at the historical trends, I agree with what you say. But if you look at the trends over time, over a period of years, you will see that linearity has been working in our favor. So that is another dimension.

And to Cathie's point, we try to be prudent. Tony brought up one, issue right? And there are other issues and we think when you net all those issues together, this is right range for us to be in from a revenue perspective.

And as always, David, as you know we will see how the quarter unfolds and see what happens out there. I would just reiterate one more time -- we're pretty confident in our position out in the market, point one. Point two, with the cost initiatives we have in the Company and the other activities we have ongoing, we're quite confident about our ability to achieve our EPS range that we've given.

Operator

Jeff Fidacaro, Merrill Lynch.

Jeff Fidacaro - *Merrill Lynch - Analyst*

Mark, just wondered if you could touch on the strength in the services side. We saw outsourcing up 18%, tech support up 13%. Sort of what trends are you seeing and how does this compare to EDS's business? And secondly how do you leverage EDS's let's say footprint in client accounts to continue to benefit from the strength today?

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

So Jeff I think it's a big opportunity. Obviously you've seen strength in services. Services many times is countercyclical in an economic environment where as economies go through some tougher times, there is more opportunity for services companies particularly on the [outtasking] or outsourcing of a piece of business and I think we've been able to benefit from a part of that.

Additionally just as a footnote, EDS's revenue you saw during the quarter strengthen to 3% growth for them which was over a period time, a better performance than we have seen and certainly what we saw as we went through our due diligence with them. So the market is attractive for services companies and services play.

In addition, I think to your question, we have to be able to give EDS innovation and capability that can broaden their ability to go to the marketplace and compete. So we're going to be very focused on trying to do things that help them automate processes, that help them operate with a lower cost structure so they can be yet more competitive in the marketplace.

And that is work that we're doing a lot of detail planning on right now that you're going to get details on September 15. But make no mistake about it. We are going to execute on the EDS acquisition and we're going to bring the strength of HP's operating discipline, the strength of HP's innovation, the strength of HP's position in the marketplace to make a combined business we think will be quite competitive.

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Cathie Lesjak - *Hewlett-Packard - CFO*

I would just like to add on the technology services side where the business had really strong growth and that is really related to our attach rate whether's that [care pack] attached or networking or managed print services. So that piece of the business is performing very well and that is obviously contributing to the HP services growth as is consulting and integration and outsource services.

Operator

Brian Alexander, Raymond James.

Brian Alexander - *Raymond James & Associates - Analyst*

I hope I'm not beating a dead horse here, but given the currency has gotten so much attention from investors and the press, Mark or Cathie, could you just clarify beyond the obvious revenue translation impact associated with currency movements can you indicate whether operationally the weaker dollar has any had any noticeable impact on your margins or your EPS growth over last several quarters i.e. what segments might have benefited from the weaker currency and going forward if the dollar continues to strengthen, how concerned are you if at all that this will impact your ability to achieve your segment margin targets for FY 09? Thanks.

Cathie Lesjak - *Hewlett-Packard - CFO*

There's no question that at the margin, a weaker dollar has some positive impact at the total company level. It is different -- frankly it is different by segment. So if you look at services as an example, we will benefit in some way from a stronger dollar in services because of how we bring on deferred revenue.

If you look at PSG as an example, the currency probably didn't help much at all because that gets factored into the price almost instantaneously, certainly within a quarter. And if you look at BCS, our Business Critical Servers, on the opposite end that probably takes longer to get the currency factored into it and you've really got to look at kind of all of these and what the bottom line impact is.

There will be some impact from a stronger dollar. But as you can see for our guidance for Q4, it's not enough to really be noticeable. We're still looking at delivering 17 to 20% EPS growth in Q4 even if the dollar were to stay at levels that [there are there] today.

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

Brain, that is a pretty darn good explanation of what happens. It is sort of a mix and to Cathie's point, services actually gets better because the deferred revenue gets booked at the higher rate and the delivery is done on a lower rate.

Product businesses generally speaking that have quick cycles flow through and when you are competing in a global market, the currency gets factored into the model relatively quickly. So it's why we've tried to say before, you can go knock yourself out with a whole bunch of year-over-year currency assumptions and they're not going to fundamentally affect the model.

To Cathie's point, they operate around the margin. So how fast does it get -- does it get through in a week? Does it get through in a month? Does it get through in five weeks? Those are the things that would affect you in a fast-moving product business.

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So for example just to give you color, if you're PSG and you're competing with a local German competitor or a local Brazilian competitor, you don't keep currency in your fingers. You pass that right through so that you could be competitive in that local market and you're competing on a local basis. Same thing happens in ISS etc. etc.

So it is a mixed bag to the point -- Cathie's point, when a get to a backlog business like a BCS where we would actually hold some backlog as we're building, that is going to have a negative impact. And then you've got to (inaudible) because we do some hedging as you know at the Company level.

So it's a mixed bag. But I would tell you that we feel really good about the strength of our operating model regardless of what happens in currency. So that would be our view.

Brian Alexander - *Raymond James & Associates - Analyst*

Just one quick follow-up, Cathie, on the payables. It has been a pretty big contributor to your of operating cash flow the last two quarters. Should we expect that to come back down or stabilize at these levels?

Cathie Lesjak - *Hewlett-Packard - CFO*

So, I think they will be -- quarter to quarter things -- it bounces around a bit. We have made some structural changes to how we approach payables that will be permanent and this is really focusing on getting operationally excellent whether that is in inventory or in payables so that we have the opportunity to make the trade-off between the balance sheet and income statement without a deterioration in metrics.

So there's a piece of that. I would say it's a little less than half of the impact was due to improvements that we have made in the DPO. The rest -- a lot of the rest of it is due to linearity in the quarter and when purchases take place. That of course will be more transient.

Operator

Keith (inaudible), Bank of Montreal.

Unidentified Participant

Mark, I had a trendline question if I could. I wanted to get your feedback or thoughts on trendlines and that is to say Industry Standard Servers had modest revenue growth even with fairly phenomenal blades growth. Is this -- and many other companies -- IBM had frankly weak (inaudible) too.

Is this the right trendline that you think HP is going to experience over the next couple of quarters? And similarly, you mentioned your being price point specific or economic specific on your printer units. How should we think about the printer unit placements over the next couple of quarters as well? Thanks.

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

Keith, I didn't get all of it. You were sort of faint and I think you were asking about the trendlines in the server business.

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Unidentified Participant

Yes, trendlines in the Industry Standard Servers, is this the right trendline even with good blades growth?

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

Well we will have to see. We will have to see. Obviously we feel very good about our market position. Unit growth was good in the quarter. So we felt good about that. We saw ASP erosion in the quarter at the same time.

So we feel very good about the blades position. Obviously you can see the numbers and that business is now a big business. You are seeing movements to in many cases integrated [1P's] forming into sort of an aggregated system for many customers as they do scaleouts and buildouts of data center capabilities.

So we think there is a robust market in data center transformation activities and you're going to see that continue to go on. So for us I think the trendlines you're seeing seem sort of roughly right from where we are. We're not banking on anything dramatically different as part of the guidance we're giving. So we feel very good about our chance to compete and that's what we will do and we will compete tough.

Unidentified Participant

And Mark, in case you didn't hear the second part of the question, what are your thoughts on printer unit placements over the next couple of quarters?

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

Again, so let me give you an example Keith. I think as I mentioned in wireless -- places that we feel very strongly about the connect rate will be tough, will be opportunistic as it relates to places that don't have strong connect rates. And I think in the printer market it is a very diversified market.

For us you go into the graphics world that has graphics, (inaudible) Indigo etc. They use liters of the ink. So, you can imagine that we will be very aggressive in the graphics market. You can imagine us to be aggressive on the high-end and in many of the high-end areas that we think make sense that have long-term placement value and installed base stays installed a longtime etc.

Where you get to some of these units that are very low-end, we will pick our spots and we will try to be prudent as we go. So I think that is the best way to think about it. We're obviously in a position because of our cost structure improvements that we've made that we've got a little bit more flexibility than we have had in the past. And listen Keith, it has taken us work to get to in a position where we have that. And we will try to make prudent decisions to be able to optimize shareholder value.

Operator

Bill Fearnley, FTN Midwest.

Bill Fearnley - *FTN Midwest Research - Analyst*

Mark, how should we be thinking about unit revenue growth here in PSG? You folks have made the comment before that the comps get harder because of the strong growth in prior quarters. But in the face of increasing competition in the (inaudible)

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retail channels by Dell, how do you see your PC competitive position here and any concern here about street pricing here for the rest of the year? And then I have a quick follow-up.

Mark Hurd - Hewlett-Packard - Chairman and CEO

Quick follow-up, huh? Bill, I'd tell you, listen. I think that for us 15% year-on-year growth -- and remember this is coming against a Q3 last year that was an extremely tough comparison. So you had 29% growth last year. This year it's 15% growth that it's being compared against -- the 15 is being compared against the 29.

So again you've got to go when people talk about deceleration in PSG if they do; boy, way those two numbers added together are 44. So that is a big, big number. So we think we're competing quite well. We've launched as Cathie mentioned a lineup of products that we've announced that we're very excited about. In fact, we announced two or three more products yet today in the low-end or the ultra light part of our line.

So we feel like we're doing a pretty good job from an innovation perspective delivering products, covering the low-end, introducing products more on the high-end of our range. We feel good about the operating cadence of that group. They have a nice job from from an asset perspective and we feel like they're pretty well-positioned.

Bill Fearnley - FTN Midwest Research - Analyst

And then to shift gears to IPG if I could, in the last call, you mentioned the shift away from laser. Does that imply that you're trying to put more focus on the graphic segment versus some of the more traditional printer businesses?

I mean you talked about liters of ink before and in light of the strong supplies performance and the restructuring in IPG then, should we be thinking about closer to 15% operating margins? Or is there near-term upside to those margins given the fact that you're doing well in graphics and you have the restructuring benefits?

Mark Hurd - Hewlett-Packard - Chairman and CEO

So, Bill, I understand the question. I think that yes, clearly we know the business -- how the business can perform. I think what we want to do is grow in the graphic segment. We think it is a very strategic segment. But I wouldn't think of it as us stopping doing this to be able to do that.

We think we can grow in graphics and invest in the growth in graphics. At the same time we can optimize the position in our -- I will call it our traditional business for the sake of this discussion.

So, we do have some capital decisions that we can shift but we feel pretty good about our position right now. And as IPG continues to improve its cost structure, we think its got an opportunity now to be appropriately aggressive in the marketplace in the segments that it makes sense.

Cathie Lesjak - Hewlett-Packard - CFO

If we go back to be security analyst meeting in December, the guidance that we have out there for FY 09 for IPG (inaudible) profit is 14.5 to 15.5. And so you can see where we are relative to that.

Bill Fearnley - FTN Midwest Research - Analyst

And you have exceeded it a number of times too? That's what I was trying to get to.

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Cathie Lesjak - *Hewlett-Packard - CFO*

Yes.

Operator

Maynard Um, UBS.

Maynard Um - *UBS - Analyst*

Can you just give us a sense of how much cash you have that's onshore versus offshore? It sounds like you have enough onshore to do a share repurchase but does that imply you can actually use the offshore cash for the EDS deal or should we anticipate a pretty big debt issuance coming up?

Cathie Lesjak - *Hewlett-Packard - CFO*

So we will be issuing debt for EDS. The vast majority of the EDS purchase will be done through debt. And that's because most of our cash is offshore. The share repurchase is typically done from operating cash from the US as well as debt.

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

When you get into our balance sheet and our gross cash and net cash, you have got to look at our financing business as we talked about at the last security analyst meeting and then look at the industrial company of HP and its cash position. And you're right -- we have a very strong gross cash position in the industrial company that could do much of the financing but a lot of it has to do with the position or the placement of the cash from a location perspective. But we can do what we need to do as it relates to being able to buy back stock if that was the crux of your question?

Maynard Um - *UBS - Analyst*

Mark, if I could follow up just on your comment about the low-end market and the PSG, do you expect -- how should we think about that in terms of cannibalizing the high-end particularly in this kind of economic environment as we move to through the rest of the year? Thanks.

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

I will speak specifically about the more ultra light PCs. We have actually not seen cannibalization. We have actually seen sort of a new market segment of all that which is pretty exciting.

So we have seen a lot of people that had this as a second or third PC. We have seen them going to demographics of people that traditionally haven't had a PC and now have something smaller that they can carry with them. So that part looks pretty positive just based on the data that we have seen so far.

Jim Burns - *Hewlett-Packard - VP, IR*

Why don't we take two more questions, please.

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Operator

Louis Miscioscia, Cowen & Co.

Louis Miscioscia - *Cowen and Company - Analyst*

So my question goes back to the server side. I realize blades were strong but when you think about a virtualized consolidated data center and [cloud] computing you think there would be a ton of demand for industry standard servers. So I guess my question is why we not seeing a lot more growth there? Is this as good as it gets or is it just so early on those things that the growth is still a few quarters out?

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

Yes, I think you're right. First of all, 13% unit growth in the quarter is a decent number but I think your point is a good one, right? You've got a 60 -- so let me try to give you context.

You've got a \$60 billion server market. That server market is made up of a lot of different types of products whether those are SMP machines, mainframes, industry standard stuff, blades etc. etc. And it is in our view a market that is going to continue to consolidate around the industry standard platform.

So we look at it as a significant opportunity that when you look at how processing is done, it is going to drive down into the core market and we look at the integration of our PC supply chain and our Industry Standard Servers supply chain whether it's from a PC up through a blade as a tremendous competitive advantage for us and a tremendous competitive advantage opportunity for us to bring to the market. I think you're going to see much of the same thing happen in storage that you're seeing in Industry Standard Servers, a separate marketplace that is going through a lot of work on virtualization, a lot of what you would think of traditionally as low-end storage being cobbled together into a very mission critical enterprise storage system and many of these things being integrated as almost hybrids that when you look at the data center buildouts and you look at it and you say is that a server or is that storage?

And in some cases it's hard to tell because the interplay is so tightly knit together and connected. So we think it's a big opportunity. I think to your point you're going to see more opportunity in the future and we feel well positioned to be part of it.

Louis Miscioscia - *Cowen and Company - Analyst*

As a quick follow-up, a third of your business is obviously on the consumer area and are you getting any signs yet on back-to-school obviously here in the US and over in Europe and even a comment on international if you could?

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

Nothing to report on that as part of this quarter. We did see renewed strength in consumer PCs in the US during the quarter.

Jim Burns - *Hewlett-Packard - VP, IR*

(multiple speakers) take one more question, please.

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Operator

Jayson Noland, Robert W. Baird.

Jayson Noland - Robert W. Baird & Company, Inc. - Analyst

Mark, you described cost reductions as substantial and ongoing again and named the same three segments -- real estate, IT and shared corporate services. I guess generally you would think it would get harder to cut costs but it seems like your cost-cutting activities are ramping. I guess the question is how were you able to do that?

Mark Hurd - Hewlett-Packard - Chairman and CEO

Listen, I'm a big believer you zero-base budget everything. You turn over a rock, you typically find another rock. Many of the things we're doing just had the -- say this the right way -- just needed to be worked. So that's sort of point one.

Second in many cases when you do sustainable cost reduction you have to invest into that reduction. So the thought that you just come in and say okay, we used to do that; now we're going to do that; in most cases you have to change the way you work. You have to change the process by which it's being executed which is frankly what we have been doing.

You know, take -- I could give you many, many examples where instead of doing something 20 times, we now do it once. Instead of having 14 things to do something, we now have one. And for us, globalizing things the best we can and doing things one time bring tremendous cost savings to us and big process efficiency to us.

Don't get me wrong in the fact that those are the only areas in the Company going through a cost reduction. We have significant opportunities going on in services. Services has done I think a nice job during this year and not all of which you have seen in its operating performance in terms of becoming more efficient. And services businesses have significant opportunities and efficiency and there are many different dimensions that drive that efficiency.

IPG is working very hard to change its cost structure and they're making some amount of progress. We have seen much of that in ESS. So our costs are overhead costs, business owned cost and our cost of goods sold and cost of service. And all of those different parts of cost have different initiatives underway to change the way we think about how we deploy our revenue minus profit which equals our cost which is now over \$100 billion worth of cost.

So we think about that \$100 billion worth of cost every single day and how we can make it as efficient as we can to give us the best opportunity to go in a marketplace and compete. So there will never be a day at HP at our scale where we're not trying to work hard to make our processes more efficient and get our cost structure right. And whether it's good news or bad news, the fact is it still is not where we need it to be. And that's why we're working so hard to get it done.

Jayson Noland - Robert W. Baird & Company, Inc. - Analyst

Just to clarify, you're ramping into fiscal '09, that's HP stand-alone not including EDS?

Mark Hurd - Hewlett-Packard - Chairman and CEO

EDS would be another story.

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Jayson Noland - Robert W. Baird & Company, Inc. - Analyst

Sounds good; thanks.

Cathie Lesjak - Hewlett-Packard - CFO

On another day.

Mark Hurd - Hewlett-Packard - Chairman and CEO

On another day.

Mark Hurd - Hewlett-Packard - Chairman and CEO

Let me thank you all for participating -- (inaudible) good quarter for us. We really felt good about it and we felt like we had balanced growth. We've continued to execute expense discipline. We've been able to expand our margins.

Our year-to-date cash flow from operations is now at \$11.3 billion which exceeds what we did in '08. We are -- I will say one more time -- confident in our EPS expansion given our cost savings and our recurring revenues and I'm excited to see you all on September 15 at the analyst event. And I'm going turned over to Jim just for a couple of closing comments.

Jim Burns - Hewlett-Packard - VP, IR

Just one more comment about the other story for the other day here. Invitations will go out tomorrow to the September 15 analyst meeting. It will be held in the West Coast here and we look forward to seeing you, hopefully as many as possible. Thank you.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Have a great day.

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