CORPORATE PARTICIPANTS

Mark Hurd
Hewlett-Packard - President and CEO

CONFERENCE CALL PARTICIPANTS

Katy Huberty
Morgan Stanley - Analyst

PRESENTATION

Katy Huberty - Morgan Stanley - Analyst

Let's go ahead and get started. For those of you I have not met, I'm Katy Huberty, Morgan Stanley systems and PC hardware analyst. It is my absolute pleasure to have Mark Hurd join us this morning to talk about the business.

As many of you know, he led HP through a significant turnaround over the last couple of years. HP has a better product position, better margins, all while outgrowing many of its competitors, so lots to talk about this morning.

As you know, the format I will start off with several questions. We will open it up for Q&A the last 15 minutes or so. Please use the mics in front of you. If you raise your hand we will acknowledge you and then quickly push a button and go ahead and ask your question. With that, let's get started.

QUESTIONS AND ANSWERS

Mark Hurd - Hewlett-Packard - President and CEO

I heard this was fireside chat. No fire.

Katy Huberty - Morgan Stanley - Analyst

Next year, I promise. So, Mark, since you joined the Company two years ago, HP's revenue is up $12 billion, operating margins up 2.5%. You have to be happy with the amount of traction you have made in just a short period, but what is left to do over the next couple of years?

Mark Hurd - Hewlett-Packard - President and CEO

Nothing. I think we're done. No, I think for us the way I would describe it is that we are doing better. We have incrementally improved the Company in most of the metrics that we track. On an absolute basis, we're not doing well and that is the good news and the bad news for us. We sat out on a vicious cost reduction plan. Much of that cost is not yet reflected in our P&L. Much of it had to do with IT, real estate, some of the overhead functions. It takes time, as I said, and I don't know that we have actually gotten very good traction with the investment base understanding that these are efforts that require time and most of that is not yet in our P&L.

So we've got work to do. We have made some progress, Katy, but not a lot. In each one of our businesses, whether it is in our service business -- our service business is a $16 billion, $17 billion piece of Hewlett-Packard. We've got a significant cost structure, not just overhead from the Company but also overhead within the business and then our service delivery costs themselves. Some of those are procured into the Company and some of those are owned by the Company.
Those have tremendous opportunities for efficiency and for us -- I could go through a lot of different detail. I won't for the sake of time today, but it is a material opportunity for us to improve our costs and in services, cost and growth are almost directly related. When you bid on a -- we grew 11% in our outsourcing business last quarter, but frankly when you bid a five-year, six-year deal, if you have too much cost, it counts five or six times and your close rate actually goes down.

So the ability to take costs out directly relates to our ability to grow. We could not have grown 11% at reasonable margins two years ago if we had not done some of the costs we've done. We just have a lot more to do. We've got work to do in our supplies business. We've got work to do in our procurement business. These are all fairly material issues for us to get through and it will take us all of the next two years to be able to take advantage of that.

I will flip at the risk of just some time, and we've got to turn this into growth because today our total available market at Hewlett-Packard is about $1.2 trillion when you get out into 2009, and we do not cover the market and this has been the reason that we are in adding sales resource. So we are trying to take our costs out, which is material. Some of that we'll have to send back in the market to continue to maintain our competitive position. Some of that will go to the bottom line. Some of that will go to investment for us to be able to capture more total available market.

And we now understand where that total available market is by industry, where it is by geography, by customer segment, whether consumer, SMB, or enterprise and where it may fit by product segment. So we are going to have to invest to cover that market all with the hope of bringing more gross margin into the Company.

So long trip through HP, I think in a couple of minutes, but it is for us nailing the costs and make sure we nail it right on a sustainable lower unit cost basis and our ability to align that to be able to go get some growth. And I am optimistic we can get it done, but we've got to show up and make sure we can deliver.

Katy Huberty - Morgan Stanley - Analyst

So you brought up revenue growth from a broader industry standpoint. We're going through a major evolution in the way we are thinking about technology and compute in particular and enterprises are rethinking, the data centers' address for power consumption, space, efficiency, and HP is doing that within its own data centers, right? We've talked about going from 85 to 6 data centers. But how are you taking that technology and turning it into product and a go-to-market strategy to bring the next generation data center to your customers?

Mark Hurd - Hewlett-Packard - President and CEO

So four simple objectives in HP IT. We have to get roughly half our costs out and our cost was just too high. Second, we have to be able to get better information and more integrated systems across the Company so that we can look from supply chain to customer end-to-end and we can do it without having to have a web of humans piece together disparate data. Third, we have the lower the risk of HP as we close the books and run the company. Fourth, we have to do it with HP technology.

And frankly if we can’t do it with HP technology, we either better acquire it, develop it or we’re going have to have a deep partnership to go get it. So we can map pretty much everything we’re doing to our technology base.

A ton of work, to your point, 87 data centers. We are now through much of what we have to do with a lot more to do to be able to get there. We will wind up blading most everything. We will blade everything. Our server base will be 60%, 70% bleded. We will increase our processing power 80% while we do it, decrease our power and cooling 60% while we do it. And I only bring up those details to you to give you an evidentiary point of the magnitude of the change you can get when you get this done.

I think you’ll see the same kind of virtualization and blading capability in storage. This stuff will all be built on commodity piece parts but into pretty complex systems. At the same time as you build a service-oriented architecture, you’re going to have to
have software binding fabric that binds those technologies and those systems together. For us why we're taking such an aggressive view on this management software category. We believe management software will be ERP like, database like in its categorization as you go forward and it is going to require leadership and we are volunteering to lead it.

We are volunteering through fairly strong organic R&D push as well as being acquisitive in the piece parts that we need. So I think when you look at what is going to happen in Enterprises, you've got too much cost being spent on labor in Enterprises today and the labor cost is inclining, not declining. As a result that has to get interrupted. Our view is the right way to interrupt it is CEOs, my colleagues, have to spend more CapEx. They have to spend more CapEx to interrupt the current flow of, if you will, inertia as it relates to their IT cost structure and what they are getting for it.

If they interrupt it, they can get the same kind of metrics that we are getting, so we really believe there is an opportunity here for companies to spend more but to get to a better destination when they are done and we are hopeful of delivering the kind of -- for HP IT, this is a collaboration not with just with HP IT but HP Labs and HP Software and HP Services. The crux of it is we want to automate everything that we possibly can. Arbitraging labor reduces costs, automating things eliminates costs and it actually improves service levels while you do it.

So it is a big effort, we think doable, and we think we have a shot to be kind of -- let's leave it this way -- well-positioned in the context of making this happen.

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**Katy Huberty - Morgan Stanley - Analyst**

So if we looked over the last year, HP's c-Class blades are a great example of innovating internally and investing internally. The Mercury Interactive acquisition is a great example of being acquisitive. What are the other pieces of the puzzle that you need to go look at and either invest internally or externally?

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

You're on them. The fact that we can come out with the best -- for our strategy to work, we have to come out with best in class product by category. So our server capability in a blade or in an industry standard server has to be best in class. We like our cost structure. We like our technology position. We like our opportunity to be that player. We have to be best in class in storage. We have to be best in class by product.

At the same time we've got to be able to bind those products together into systems. So it is not going to be good enough to just be good in products. We're going to have to turn those into integrated systems. And so when you look at -- if you were to go in and look at a blade datacenter -- a bladed data center, it might sound like a commodity piece part to you until you see it working together as a system. And these things are very complex. So being able to nail with power rating systems, being able to dial it up, dial it down, being able to deal with cooling, and being able to deal with all those things are important and so you will see us make investments in those kinds of things, Katy.

I think in addition you'll also see us make investments in information management like we have done organically with Neoview trying to take all of the improved data sets together and be able to leverage those across the Enterprise and get the information to who needs to have it when they need to have it. We think we have most of those capabilities organic to the Company today.

So you'll see us active but active on the organic front. We will be acquisitive in the spaces I think you have seen us be acquisitive in where we think it makes sense.
Katy Huberty - Morgan Stanley - Analyst

So Neoview is HP's first real entry into data warehousing and [BI]. How are the beta trials going and when should we look for that product to really go to market in an aggressive manner?

Mark Hurd - Hewlett-Packard - President and CEO

I think for us in that market, that is a market that you've got to nail it right. You've got to do it kind of one customer at a time to make sure the technology is ready for prime time. We are doing that right now. We have got some very -- I'll use the word significant beta customers that we are going through.

We feel very good about it, but we would not rush to market. This is not a market that you rush to market. This is a market you nail. If you get the first five customers right, you'll get the next 20 right. If you get the next 20 right you'll get the next 50 right. So for us, it is that kind of process and we feel like we've got most of those capabilities now in the Company to get it right. We are using HP IT as our beginning rounds and we feel good about that.

I would say, though, that it also fits into a bigger set of offers that we're bringing to the market. I think the fact when you combine all of our assets and HP Software, our IT and data center transformation, our applications and management capability, because most of these renewals in IT do not just come with just datacenter realignment. They also come of application realignment and application modernization.

So it is important for us to come with a services capability and application and IT capabilities and IT transformation, data management. I think when you look at our tools from an HP software perspective, it puts kind of a different position if you will on HP than we have had in the past. We think that is a good thing.

Katy Huberty - Morgan Stanley - Analyst

So we just went through the enterprise side of the business, but let's look at consumer for a minute because there's also a major evolution in digital content everywhere and it is not necessarily going to be the PC of today that is the PC of tomorrow. So what do you need to do to evolve that product portfolio and go to market strategy if at all to be the top PC vendor not just today but in three years?

Mark Hurd - Hewlett-Packard - President and CEO

Well, we feel real good about our portfolio. We feel good about the product portfolio. I think we benefited from growth in emerging markets, growth in consumer and frankly growth in mobile as well. I think that is the spot and we don't see much of that changing.

When you take the consumer now and take them away from being mobile and then go to the home as you kind of took us to, Katy, I think you'll see evolution not just at the device level. I'm not sure we are convinced that there will be a ubiquitous device that will dominate the consumer. You'll see various device types. I don't know about how you think but I can't get everybody at least in my home to agree on anything, so -- and I try. It doesn't work.

So in the end I'll think you'll see different types of devices, but I think you'll see a lot of work done on a software [levers]. So the fact that now with our media smart capabilities you have already seen us release, you can now gather content from multiple nodes coming into the home, whether it is through coming on the TV network through cable, whether it is coming from the Web; whenever it may be, I can now bring all that stuff into a single device. So we feel really good about the development from a software perspective that we have got to do.
I think the big issue in the home is going to be the simplicity of it. So I can give you a simple example. I give this in the speeches I give. When you first used your telephone for the first time when you were a young kid, did somebody give you a manual? Did your mom sit you down and teach you how to use it? So it has got to get to that level of simplicity that I don't have to go through hours and hours of training to be able to get access to all this content. So there's room for a lot of innovation to get that done.

I think a good example in the consumer you've seen us innovate on is this activity we've done with the big retailer where we have actually digitized a lot of content so there's content coming for studios basically movie content and taking it away from analog, moving it to digital. Then vaulting if you will that capacity and then allowing that capacity to now be dialed up into a retail location.

So instead of going through or sorting through 100 CDs, I can now look at a list of titles and then I can actually burn the CD straight from the vault right in the retail location, eliminate all the inventory, and simultaneously increase my choice. Those kind of innovative capabilities -- you can go take that example and bring it to the home, bring it off the Web, bring it off the personal products, etc. Tremendous opportunities for innovation in simplifying the supply chain, making the job easier for consumers. And you know given our base of printers, given our base of PCs, we have a big -- we think we've got a shot at being one of those players and we hope to capitalize on.

Katy Huberty - Morgan Stanley - Analyst

So you have $10 billion of cash on the balance sheet today?

Mark Hurd - Hewlett-Packard - President and CEO

That's good news.

Katy Huberty - Morgan Stanley - Analyst

That's great news, but ultimately you want to do something with it. So how do you balance the return or prioritize the return to shareholders versus making sure you have enough on the balance sheet to make the acquisitions you need to make to evolve with the technology landscape?

Mark Hurd - Hewlett-Packard - President and CEO

Again for us, we have to perform operationally and we're trying to increase our ability to generate cash, not decrease it. So I'm very -- I will say this one more time -- I'm very, very confident in our ability to continue to generate cash.

Now as we generate cash, we will look through it through a pretty simple lens. We will use our cash as our operations perform better than what we can invest our money in a bank, we will invest in our operations. We think there's plenty of growth opportunity in the Company which we can return better than we can getting cash from a CD or something along those lines.

Secondly, we believe in our own shares and we will continue. I have used the term before, I will use it here. We'll continue to be active on our shares. We believe them to be undervalued -- they believed to be -- undervalued based on where we think we can drive the Company. We'll continue to be active with our shares.

And thirdly, we will be acquisitive but we will be acquisitive in the context of a pretty simple formula. Does an acquisition make strategic sense? Yes/no. If the answer is no, you can't go to the second question. The second question is does it make financial sense for us? If the acquisition makes financial sense for us, can we actually operate it and run it in a rational, prudent way that
is going to make sense for our Company and not throw us off track with what we'd like to get done with the rest of the company? If those three factors are in place, we will consider an acquisition.

I think has been the same formula we've used for the last two years and that is where you'll see us active. So those are the formulas. We are always relooking at our dividend at the same time. We are not ruling that out, but our priorities would be in the order I described.

**Katy Huberty - Morgan Stanley - Analyst**

Let’s dig into a couple of the businesses. Imaging and printing generated a lot of cash. You are tracking that business above your target margins even after growing a solid base with lower profitability hardware, so why not take some of that margin upside and reinvest that back into pricing to accelerate market share in the commercial side of the business to defend against some of the new entrants to the printing market?

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

So I think again, I think we're doing that right now. I think when you look at 18% unit growth in the installed base, that is big growth in the market. I think when you look at our share gains, they are material in terms of what they've been done -- often a market share position that is already pretty strong.

We've got to make sure that we don't get so strung out on the unit growth drug that we are after low usage segments. So I think you can go get unit growth but not all unit growth is created equal. So when you go to low usage segments, you can wind up with a high unit growth number but frankly it is not a gift that keeps giving to you. So we’re trying to do very good, disciplined work by segment to make sure that the unit growth counts.

It is also important where we get that unit growth. The unit growth in emerging markets is lower than what it is in the term markets because of fraud and because of lack of legal support that we get in some of these emerging markets. Now that is improving but it is not improving fast enough for us.

So emerging market unit growth is still good growth. It’s still got good ecosystem economics, but it is not at the same ecosystem economics that you can find in a term market, where some of these laws are forced at a better level than they are in the emerging market.

So we’re trying to get this all into consideration. At the same time, we have adjacencies in IPG that are extremely attractive, so it is not just pricing in the consumer market. It is also the opportunity in the enterprise market for us.

At HP we have got a great technology base. We've got a great service and support base. Selling has not always been our forte, so we're trying hard to go into the enterprise market, which is a -- if you look at the top 10,000 buyers in the world, is a $140 billion market and we have less than mid single digit share of that market. And that market is not growing. So when you back back to the macroeconomic market, you would say to that market, that $140 billion is faxes, copiers, single function printers, multifunction printers, software and services.

But it is extremely attractive for us because that market is moving to digitization away from analogue to digital. It is moving away from single function copiers into multifunction devices. It is being integrated together with services. We bring multiple levered pieces to that enterprise offer. We bring our own hardware, our own supply structure, our own services, our own software that’s coming from HP software. So it is a market for us that might not look attractive to a macroeconomic modeler but it looks attractive to an opportunity to go build a share position from.
So we look at those pools and we are trying to optimize those pools in a way. At the same time, clearly they are doing well and we are pleased with their progress. We can just do more.

Katy Huberty - Morgan Stanley - Analyst

So services business -- and I don't want to imply that you want to look like IBM because I don't think that's the case, but if you at look the two businesses, IBM's attach rate for services to the rest of the enterprise business is much higher. You talked about cutting costs which allows you to go after incremental deals. Isn't there an opportunity in the next couple of years to improve HP's attach rate and drive even more growth in that business?

Mark Hurd - Hewlett-Packard - President and CEO

Yes. Do you want me to expand? Okay. (multiple speakers) It's a yes/no conclusion. I think for us if you compare those two companies, you're comparing a company with 5X the scale in outsourcing than we do. The services business looked closer together but the mix of the two services businesses are quite different in the way they are composed.

That said, within what we call OS piece, outsourcing piece of our business, we can clearly improve attach rates and certainly that is a big objective when you are a portfolio company is to be able to leverage those attach rates. We have had to get after the fact that we were on a growth rate that we were growing with business that in my opinion was not going to be a profitable business even with appropriate attach rates. So we needed to go mind the store and we could not have grown 11% profitably two years ago. We could not have done it.

And so as a result we took a time out last year and stopped. We are too well to keep well to keep bidding these bad deals because you don't get out of them and they stick in your P&L for five or six years and you're going to be apologizing for them. So we went customer by customer trying to redo deals. Part of that is attach because most of our customers are going to spend that money anyway. They might as well spend it with your partner that's doing the work. And now we also have to make sure we give them a good environment and appropriate pricing and appropriate leverage, etc., etc.

But yes, we can improve that but we can also improve the core fundamentals of the business. We have to automate more things. When you take on a datacenter from a customer, a customer gave it to you for a reason. Typically they gave it to you because it's screwed up and they don't know how to fix it. So if you don't have the tools right, all you've done is inherited a screwed up underleveraged capability. So you have to transform it or else you're not going to make any money either.

So for us it requires us to go do the same thing we're doing in our organic IT organization, which is to build out our capabilities and our processes to bring leverage to those customers. That is why it's important for us to take costs out of our services business. We'll get the overhead of the Company right someday and we are working on it. But then we've got to get the overhead in services right and then we've got to get our delivery costs, both remote delivery and on-site delivery right. And the way you do that is to automate as much of that stuff as you can.

So we're spending cap -- we have been spending CapEx and services and continue to because we're trying to invest in the process. We think if we do not only do we get a better attach rate, but frankly we get a better process which should improve our close rate and our margins, but we've got a lot of work to do.

Katy Huberty - Morgan Stanley - Analyst

Okay, so I want to spend a quick minute on Dell. Over the past 12 months Dell has struggled to find the right balance of growth and profitability, clearly creating opportunities for others in the industry, perhaps most HP. As you look forward, how are you
preparing HP in a more defensive manner if Dell does get back up on both feet and find the right balance of growth and profitability over the next twelve months with Michael Dell coming back as leader?

Mark Hurd - Hewlett-Packard - President and CEO

I don't know much about Dell, so I've got ideas and I could give you -- speculation and so forth. I know for us what's important is we have got to get our act together. That means for us getting our cost structure right, getting our product designs right, having our distribution channel right, having our service and support right. We are making investments in all of that. We've made big investments in Web support, big investments in our call center support, which I think have paid off for us. I think the metrics speak for themselves.

I think we've made a great investment in product design, which has helped us. I think when you look at the growth in the market, the growth has been in those three segments I described. They've been in consumer. They have been in mobile and they have been in emerging markets. And I think we've made the right investments to capture that growth.

The market in the desktop particularly domestic U.S. desktop business has been paltry at best, which is not a place that a lot of innovation is going to solve. I think you will further see technology segmentation of the PC market. So when you look at the PC market today, that PC is a very underutilized device that sits on the desktop. Today you can now do -- companies can do a better job segmenting who that power user is and who that mobile user is and I think what you're going to see on the desktop is more thin client and more of that work being done at the server forum and less of that work being caught up in an on-desktop application suite.

That is an opportunity for us because of our position in the server market and our R&D and our ability to virtualize much of that and we think take advantage of efficiency opportunities for that customer.

And then we see the rest of a workforce frankly being defined as mobile and that mobile workforce is going to want more than a device. What we see in mobile workforces today is obviously high levels of support and high levels of integration. They want to have search capabilities. They want to have security capabilities. They want to have a whole suite of capabilities that frankly require in my opinion some level of R&D and levels of integration to get that done.

So I think for us to be able to maintain our position or extend our position, we have got to be able to play to what the customer and the consumer wants. And that is what we'll focus on. So we'll get our costs down, work on product design, work on our support levels, and work on our levels of integration. And we think we've got a shot.

Katy Huberty - Morgan Stanley - Analyst

Okay, one last quick near-term question, then we'll open it up to the audience. Last quarter inventory grew a little more than people would have liked to see, cash flow in negative territory. That is clearly a top priority for you. What is the game plan to get both of those line items back moving in the right direction as quickly as possible?

Mark Hurd - Hewlett-Packard - President and CEO

I have heard this since we did our quarterly results probably more than I thought I would have and maybe I did a bad job explaining this on the call, but I want to make sure I set the record straight here. We modeled a very low cash flow quarter because of our bonus that we paid out. I will say one more time the Company deserved the bonus it got paid. Forget me. The people in the Company deserved it based on the performance they delivered. And that was modeled into our cash flow assumptions for the quarter, which was a very small cash flow for the quarter.
Now inside there we did buy ahead inventory, most of it because of Chinese New Year. So with the Chinese New Year because of the velocity and you’ve seen the numbers already -- I won’t go into any predictions -- but with the velocity we have going through it, you don’t want to get short of supply. So we bought ahead a week based on that Chinese New Year and the answer came out the answer.

So I don’t -- when we say fix it, it is not like, wow, some number came in there and we said holy cow what happened there? We knew what was coming and we specifically if you talked about the sloppiness we had in inventory, it was about this size of sloppiness. Somehow after the quarter, its come out like it’s this size and I want to tell you we are not confused about it. We are not confused about good inventory management. We’re not confused about good cash flow management. It is near and dear to our hearts.

So we hope to see improved metrics in Q2, but I think you’ll see cash flows at good levels. We only pay a bonus annually, so we think you’ll see that in Q2 and out for the rest of the year. So we feel pretty good about our inventory position. We wanted to be positioned where we thought was appropriate based on the demand we were seeing. We feel pretty good about it.

Katy Huberty - Morgan Stanley - Analyst

Okay, great. Let’s open it up to questions in the audience. (OPERATOR INSTRUCTIONS)

Unidentified Audience Member

Could you tell us a little bit more about your software strategy? What else do you [envision in] HP software portfolio other than systems management and info management? Also what is the rationale behind your potential interest and a stake in SAP?

Mark Hurd - Hewlett-Packard - President and CEO

Okay, I don’t anything about the last point you made, the rationale for a potential interest in SAP. I don’t know who is working on that if anybody at the Company. I hear rumors like that all the time that we are interested in this or that and one thing I will tell you, we look at almost everything but the number of things we’re really thinking about doing are on a much shorter list of things.

So again from a software strategy perspective, we believe the management category which is a broad categorically the way we define it. It would include storage management, it would include systems management, it would include network management, it would include security, and we believe that companies today have a plethora of suppliers giving them fragmented offers within the context of what I described and that those capabilities will morph into a category and that that category has an opportunity for integration and leverage and that's what we're trying to do.

So that's why you saw the acquisition of Mercury. Mercury was a company with maybe 2%, 3% product overlap with HP's open view, so it was almost a one plus one equals two from a product go-to-market perspective plus lots of leverage from a sales perspective and fills our leadership position in a pretty strong way.

So I think you’ll see us do more actions organically with R&D to fill out that scorecard and perhaps even some that's acquisitive as we go.

Katy Huberty - Morgan Stanley - Analyst

Other questions back here?
Unidentified Audience Member
You talked about thin client and I think we've been hearing about that there maybe five or ten years but it finally does seem like it's starting to happen now.

Mark Hurd - Hewlett-Packard - President and CEO
Where are you? This is a great -- you are exactly right. I'm going to try and find you. Okay, go ahead, thin client.

Unidentified Audience Member
So with respect to thin client, why do you think it is starting to happen now? Which verticals or types of applications do you see it happening? And how pervasive do you think it's going to become over the next couple of years?

Mark Hurd - Hewlett-Packard - President and CEO
I think you'll get as we get more and more discipline into IT and you get more and more discipline from the CEO towards IT and you get more courage in the governance of a company, I think you'll see more and more mandate that if you are a call center operator you're dealing with a basically deskbound job and you don't really use -- with local applications you'll see people going to thin client.

And I believe those kind of moves are going to have to be mandated more than they are choice to occur. So I think you're going to have certain decisions on ability and thin client that come directly mandated from the top of the company.

By the way, if you're mobile, I'll add to it. Are you going to be mobile with a standard device or mobile with whatever device you want? I think most enterprises are going to mandate what device you have and what software integration gets done at the top of the enterprise from a security and a distribution of sensitive material perspective and even security that sits on the laptop I think is going to become a bigger and bigger issue as you move forward.

So I think you're going to see some speed as you look at this next set of refreshes and you look at some of the implications with some of the new technologies out there and the potential increase in cost per seat, people taking a harder look at what this will mean. So I think you'll see an inflection over the next couple of years in that thin client opportunity and we think it is a good position for us to be in. And we're willing to move kind of both ways with the customer and consult with them on the way to go deal with that.

Katy Huberty - Morgan Stanley - Analyst
Other questions? Okay, one segment we didn't touch on is the high-end servers and storage business, which underperformed much of the rest of the enterprise business. You talked about wanting to own every piece of the data center. So what is the strategy to either invest in better product, better salesforce internally or is there the possibility that we see you partner more in some of those areas that are not as key and you need large investments to go after high-end storage portfolio or a high-end server portfolio?

Mark Hurd - Hewlett-Packard - President and CEO
Right, so first of all I would separate those two discussions because I think they are very different stories. I think when you look at our business critical systems or our high-end services as you described it, you have to look at the ecosystem of that with
blades, with our ISS business -- which is I'm sorry -- industry standard server business. We grew ISS 10%. We grew blades 45 in the quarter. BCS was down mid single digits with a 75% growth of our Integrity new flagship line within BCS. And I think you've got to look at that whole integrated lineup and say what does that mean in terms of the way people are computing and the way our installed base is evolving?

So I don't know that BCS will ever be a 10% growth business for us again because of the way we see the evolution of processing occurring. In storage, it is another story. We have a big tape business and it declined and people are moving more and more to online DASB and near line DASB. And you saw our EVA, which is the flagship of our storage products, still grow 18% in the quarter.

So do I wish it 24? Do I wish tape didn't decline as fast? Yes and I think from a storage perspective it would not necessarily change our strategic swing, which is to continue to build on the stack above the DASB. So I think a lot of people can turn sheet metal around a commodity [drive]. The real key is what you're doing in areas like storage resource management, what you're doing in archiving, what you're doing in the ability to refresh and replenish the data. So for us that's where we're going to be making our investments.

I think move we made with PolyServe last week, which was an acquisition we made, the moves we made with OuterBay, with ApplIQm have all been software stack kind of moves. I think you will also see an evolution in storage which is more blading of storage and I think you'll see an integration of server capability with storage capability as you go together.

So I think you're going to start looking at more complex ecosystem evolution because when you go to a big web farm, you're going to find that a lot of that is raw processing capacity directly aligned to that storage capacity and our industry standard server market position gives us a tremendous leverage point in that part as well.

Don't get me wrong. We can do better in storage and this is an area we can be better in to play out the strategy. I wish we'd been faster, quicker to get that done and we haven't. We just got to go about the job of getting it done.

Katy Huberty - Morgan Stanley - Analyst

Any other questions from the audience? Here in the back?

Unidentified Audience Member

You mentioned blades as being a key part of your consolidation and your data centers internally. Based on the data questions IDCs and so on, I think blades are still on a very low double-digit part of the server market. Do you see that changing and what would make that happen?

Mark Hurd - Hewlett-Packard - President and CEO

I think it is changing pretty quickly as we speak. Right. I mean you looked at our growth, 45% in blades of what is now becoming a material number. We're into comparisons against hundreds of millions of dollars opposed to a $5, so just when you look at our own numbers it's growing 4.5X as big as our industry standard server business. It is actually in the industry standard server 10% is the blades growth. So it is turning into a material number. If you run those growth rates out -- I won't run them out for you -- but if you run them out long enough, they start turning into a pretty important part of our portfolio.

So I also think when you see somebody like HP from an IT perspective putting mission critical apps on blades, you're going to see an acceleration from CIOs who say wow, now I have got core apps that are sitting on big bladed infrastructures and you're going to get acceleration. So we think you'll see acceleration there.
Unidentified Audience Member

Is it power and cooling or are there other things going on in the virtualization (inaudible)?

Mark Hurd - Hewlett-Packard - President and CEO

Listen most bladed infrastructures don’t come along with just a singular focus on a blade. They come typically with a view of the application suite and what’s happened to the application suite at the same time. Most people go through some sort of application transformation, modernization, put whenever adjective you would like there. Then integrate that with the right processing backbone to go do it.

So I think for us it is being able to deal with the services capability of application modernization, IT consolidation, IT cost reduction, IT realignment, and the ability to be able to deliver a point product like a blade, a C-Class blade as Katy mentioned that we think we’ve got a pretty strong competitive advantage in the raw technology. Then it does come with the opportunity to reduce power, to reduce cooling. And then also the valving capability to now spin up here’s how much power I’m going to put into this blade and I can also -- a lot of people can scale up real well. Not a lot of people can scale down real well.

So once I scale up for peak times -- you know, if I’m at Morgan Stanley, huge IT infrastructure. You guys have a great team of IT guys there, but they have to scale up for peaks like last week in the market. What happens when the market comes back and they want a scale back down? They’ve got to be able to turn those knobs back so they don’t wind up with a cost structure problem all at once. And there’s a lot of that kind of intricate technology to get involved but it’s got to circle around the business problem and applications as well.

Unidentified Audience Member

(Inaudible question - microphone inaccessible)

Mark Hurd - Hewlett-Packard - President and CEO

I’d love to answer it if I could hear it.

Unidentified Audience Member

What is HP’s strategy around virtualization and which organization at HP owns that particular part of the infrastructure?

Mark Hurd - Hewlett-Packard - President and CEO

Well, application virtualization generally speaking fits in both -- our ESS organization, enterprise server and storage, is the ones that really revolve around efficiency and the use of the server and the virtualization strategy of the company. We bring software assets from HP software to help align and support that. So you’ve got capabilities coming from both, but ESS would be the core owner of virtualization.

Unidentified Audience Member

HP is in a lot of different businesses that don’t get a lot of attention from Wall Street. In consumer electronics you’re selling TVs; you’ve got handheld phones. You’ve got Snapfish. I was wondering if you could talk about some of these businesses that don’t get a lot of attention, and also maybe videoconferencing efforts?
Sure, Snapfish I will just speak for a second. I think we’re going to run out of seconds here, but Snapfish is really part of -- nothing we do really is devoid of our strategy in the end. Snapfish to us is part of a triumvirate to get at the consumer. We believe there’s 11% growth in printed pages in the world, which is really good news if you are us, but the pages are bouncing around. They are bouncing to the Web and they are bouncing to the retail locations.

Snapfish in the photo world now has 35, 36 million users all using HP infrastructure to deliver those photos back to the consumer. Snapfish is the backbone behind many of your most popular retail websites photo capability. We don’t care about branding it Snapfish. We only have one conviction and that is the HP infrastructure at the retailer being sold by the retailer to the consumer and behind Snapfish as we do it. So it is really an intrusion of those three.

Our videoconferencing halo, which is really a cool capability, is all about delivering content directly to corporations so they can actually look at a content in real-time live as part of our enterprise strategy. So none of these things are void of a strategy -- we don’t get into a business just because it sounds cool. We’re not contemplating to get in the timber business or anything like that. We all want to revolve around these core strategies that we’ve got.