FINAL TRANSCRIPT

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PRESENTATION

Robert Wayman - *Hewlett-Packard - CFO & EVP*

(AUDIO IN PROGRESS) -- came with a lot of (indiscernible) industry knowledge. That really helped from outside CEO hire -- very, very aware of what we are doing. But in terms of impacting Hewlett-Packard, I think you'd have to go to his operational focus. He is just a very focused operating manager. He loves numbers, not just financial numbers, but all kinds of operational statistics.

And we saw that very early on and he certainly used that to bring a clear focus on execution, on goal setting, etc. first within his direct reporting team but. But what is interesting is I have been pleased to see how his toolbox of using metrics to monitor and drive improvements has percolated to other levels of management within the Company. So you really see that being picked up at other levels. So I think the real change is in the improved execution that we have been able to demonstrate here.

Where we are today is certainly influenced a lot by that, but I do believe that, and Mark would acknowledge, that a lot of what was underway at HP at the time he came here was the right stuff to be underway. Hasn't really changed much the focus of what we are doing. If you look at things, which I will be referring to in some other questions I know you will ask, if you look at things like attach rate, we were focused on attach rate. You can go back to the security and analyst meeting two years ago before Mark got here and that was the highlight of how we were going to try and drive gross margin improvement.

So some of it was underway. Certainly the Company was a stronger presence in the marketplace based upon the Compaq acquisition, a core upon which we have built since Mark has been here. But a lot has to do with bringing better discipline.

QUESTIONS AND ANSWERS

Brian Alexander - *Raymond James - Analyst*

Now one of the things that Mark did early on was collapse the org structure, dissolve some matrices. Can you talk a little bit about how the org structure has changed and what tangible benefits the Company has realized as a result?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

So I will just mention two things. One thing he changed was to break up the combined sales organization and take its pieces and assign them back to the business segments that had most of the volume in that particular sales motion. Now we leverage business segments across sales motions. There's none that aligns perfectly with any one business segment. So we call it the hosting function of those sales. So the retail channel is hosted by inkjet and printing, etc., etc. So he realigned those with the businesses, which does indeed shorten the decision-making and communication supply chain.

The reality is that was back to the future because we had been in that position about three years before. So it was coming back to something that many of the businesses were comfortable with and I think it has helped us get a closer alignment of the business investments, the go-to-market activities and the sales motion themselves.

Another thing he did that was completely new to the Company was to totally align what we called the horizontal resources, things like finance, HR, etc. Totally aligned them with the global functional leader. So prior to that point in time, using my own example, I had a bunch of the finance people who reported a direct line to me and I had budget responsibility and then there was a bunch in the businesses who had a dotted line up to me. Now they all are a solid line up to me and I have complete budget responsibility.

You say what is the big deal? The big deal is in accountability. Because what it has done now is made me and my counterparts accountable for the numbers that I have to produce and very importantly, it has removed that spending, the finance spending that I always had some influence on, it has removed that from the business statements when it comes to their goalsetting and performance measurements.

So we have a business-owned operating profit and then on top of that comes in allocations from people like me so we can get a fully loaded financial statement. So it takes away, if you will, the distraction or even the excuses from the businesses as to what are you really responsible and accountable for. And I actually think that was a simple change, but it was a big step in clarifying accountability.

Brian Alexander - *Raymond James - Analyst*

Now yesterday at your securities analyst meeting, you introduced a financial model for FY '08. For those that were not able to attend or listen to the webcast, can you just give us the highlights of your growth operating margin and EPS target for FY '08?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

Sure. I'll just deal at the Company level unless you want to go segment by segment. We can maybe generalize about some of them. But at the Company level, we have presented a preliminary '08 financial model where we talked about 4% to 6% top-line revenue growth. We have given guidance for '07. So all of this is intended to apply on top of that guidance. I won't take you through the numbers; it is all out there for you to read on lots of different sources.

4% to 6% kind of growth rate, an operating margin of 9% to 9.5%, which is nicely above where we are today, and a couple of other important technical elements. Other income and expense, I gave some guidance on, tax rates. I did guide for the first time in a number of years an expectation for a slightly increased tax rate. We have been operating at or below 20% and I indicated that based upon the improving profitability of the Company and where that improved profit is likely to appear geographically and by business segment, it starts to put pressure on the mix of tax rates. We have a lot of low tax profits, but they will not be growing as fast as some of the higher tax profits. They have not been and will not be as we go forward.

The share count -- end up with ultimately an EPS midpoint of $2.88, which is really not much different than where '08 consensus is for those analysts who do an '08 model. Not all of them do an '08 model at all, but that is where we are.

Most of the businesses we expect to grow in that 4% to 6% range. Software above that, about 10% to 15% and our profit margins range all over the map. From personal systems, we are guiding to about 4% to 5% margin, which is above where they are today. To IPG on the other end, that is imaging and printing group, if I use acronyms, you don't know, just let me know, in the 14% to 15% range. We had previously guided at 13% to 15%. So we're a little more confident so we have moved that up just a little bit.

Probably the biggest change in the guidance was in services where we moved it up a couple of points. So we are now saying 11% to 13% operating margin in our services business and they operated at about 9.4% this past year. So that gives you some sense of what we communicated yesterday.

Brian Alexander - *Raymond James - Analyst*

Now you have also talked about a number of cost savings initiatives and yesterday, you were very clear that this is not a one or a two year cost saving story, that this is going to continue. But if we were to go from FY '06 to FY '08, your operating margins were a little bit over 8% in FY '06. As you mentioned, 9% to 9.5% in FY '08 and one could potentially get all the way there, almost all the way there, just factoring in the savings from some of these programs; headcount reduction, real estate consolidation, IT data center consolidation. So I'm just trying to figure out and I think others are too, how much of this margin improvement over that two-year period is coming from these holistic cost savings efforts that are going to touch all segments versus profit improvement at the actual segment level?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

Okay. This is going to be a multi-part answer because there are really a lot of dynamics going on. So a lot of the fundamental cost savings that show up in '07 and '08 come from the horizontals, which includes IT, real estate, finance, etc., etc. But importantly, there are dynamics within the businesses as well.

Some of the businesses are planning on modest gross margin improvement perhaps offset by investments. We have already seen that in '06. It's certainly going to continue in '07. But for the folks here, we announced six or so months ago that we were going to be taking some of the cost savings and driving them into increased go-to-market investments. Some of them in the form of salespeople, enterprise salespeople in the computing space, trying to move more effectively into office printing, both at the office level, industrial printing, commercial printing, etc. So we have been adding, we have added hundreds of salespeople funded by the savings and that ramp will continue. We haven't given the exact numbers of folks, but it certainly will continue into '07 and we will seek -- we will look quarter by quarter at how we are doing on profitability by business and decide if further investments make sense.

Some of those investments, as I said, are in people. A lot of them though are in what we call go-to-market funding of one sort or another. Be it advertising, promotional activities, certainly we have seen the computer as personal again, ads showing up in HP. So variable spending to drive demand and demand generation funded. So it's both of those. Those are both examples of where we have made investments.

That continues throughout '08, a continual savings, decisions made about how much that goes to the bottom, how much of that gets reinvested in the business.

Brian Alexander - *Raymond James - Analyst*

And you touched on some growth initiatives because clearly this is not just a cost-cutting story, but you're going to be redeploying in many cases 50% of savings into key growth initiatives. So with such substantial opportunities from a growth standpoint that you haven't yet touched on, why are we still looking for revenue growth in that 4% to 6% range? Does that imply that you think the market is going to be slower over the next couple of years or that there is some business you may walk away from because I would think that maybe the growth rate would be a little bit higher than that?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

Yes, a lot of questions along this line both at the meeting yesterday, as well as some one-on-one meetings that not only myself, but others, did yesterday afternoon. And for whatever reason, our view of the market potential is a little more conservative than I think what some others think. We look at the total available market. We threw out a number yesterday in '09 of $1 trillion for the kinds of businesses that we are in to date or near adjacencies that we have already claimed an interest in.

This is not though just the computing market. Remember, we have a very big printing business. So this also includes such things as the copier market. As you may or may not know, we started focusing, introducing products that could actually compete with copiers several years ago. Several years ago, we had almost no marketshare in the copier space. We now have about 19% share in what is referred to as the S1 to S4 copier space. That's great. We are gaining share. But the copier market is flat as a pond. I mean it is just not growing at all. So that is a part of our total available market.

You mix in zero growth with some other pieces that indeed are 6% to 8% and we come up with a market growth, the total available market growth, below that 4%, below the bottom end of our growth range. So we think 4% to 6%, assuming we continue to gain some marketshare as we have done, is about right.

We don't try to do any macro economic forecasting when we come up with these guidelines. Who knows what the macro environment will be in '08? Who knows what the currency rates will be in '08? So we are not trying to make a call there. Although certainly the slowing in the U.S. that has occurred in '06 gives us some reason to not push it. I mean we want to be thoughtful, but again we are not trying to forecast, but we don't want to set expectations that are too aggressive.

Brian Alexander - *Raymond James - Analyst*

And which of these growth initiatives would you say offer the most revenue potential for HP over the next few years if you had to just kind of rank order some of these key initiatives?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

I think printing is probably the largest and when I say printing -- HP's history is in desktop printing if you will, which then got to shared printing in the office and as I just mentioned, now moving into higher levels, higher volume printing opportunities that were typically -- the needs of which were met by copier companies.

But beyond that, we have efforts underway to move into digital commercial printing. Be it from marketing collateral, particularly low run customized marketing collateral. We bought a company called Indigo about four years ago that has products that put digital output and can do marketing collateral. It is used for example by -- Indigo is used by Snapfish to do high-volume photo printing, digital photo printing.

So that is an area that we are focused on and increasingly industrial printing. We did another acquisition about a year ago, Scitex, which does billboard printing and major signage and other industrial applications. We have long had large format printers based upon the inkjet technology, which has gotten into industrial printing applications and we are driving that forward.

You saw yesterday a video on our new Edgeline technology, which is a huge extension of the typical inkjet nozzles that have been driving our printers for many, many years, which just get smaller and smaller, faster and faster, aligned for bigger printheads so that you can do higher capacity, higher volume prints with inkjet printers. So now you can do a page in one pass with this. It has already been introduced in products that are just becoming available in the photo kiosk space. So when you go into a whatever retail store and you put in your little memory card and choose the photo that you want and press the button, it will be Edgeline technology creating those photos and they pop out like that. I mean it is just very, very quick. I can't remember the number -- a billion dots per these things can put out. It is just unbelievable what can be done.

So we are going to be going after other areas of printing and I will just give you one other statistic. For years, we used to show the page count, the printed pages in the U.S. or the world, pick whatever one you want and about 8 to 10 years ago, we said 5% of the printed pages were available to us based upon the products that we were producing at that point in time. Right now, it is around 8%.

In 2010, we think it will be 10% as more and more content is digitized and as we bring these kind of capabilities at higher volume levels. So it is a big opportunity and it is all a similar model to where we have done so well in IPG. That is the hardware is one thing. Maybe you will make a little money on the hardware, but the supply stream just goes on forever.

Brian Alexander - *Raymond James - Analyst*

Now a lot of the growth initiatives are centered around the enterprise space from a customer perspective. When you look at the SMB space, what is HP doing to drive better penetration, better growth in SMB?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

Again, a couple of pieces of that. First, I will pick up on where I just left off. In the printing space, a lot of that is focused on SMB. A lot of the Scitex and Indigo kinds of products and our own multi-function printers, these are your small engineering outfits, your small marketing outfits, etc., etc. So it is not just large enterprise. These things fit -- in fact, we view the sales cycle in those arenas to be mainly a, not so much the small, but the M in the SMB.

If we go to computing space, certainly we believe we are underrepresented in the SMB space. While we have a great channel program with great reach, we think there is more marketshare for us to gain in SMB and we intend to go after SMB through the various channels that we talked about; many of which are represented at this conference today.

I will note for completeness and point out that we think the retail channel also reaches at least the S portion of SMB and that is an important channel to us as well. So examples, in the storage space, we introduced some new storage that we think is particularly well-suited to the SMB space. We have introduced programs with a number of our channel partners to increase start-up funding of storage specialists that are their employees, but funded at least in part by Hewlett-Packard to help increase our penetration in the SMB space with those kinds of products and now resources to take them to market. Those are some examples, Brian.

Brian Alexander - *Raymond James - Analyst*

Great. Shifting to cash flow, you provided some cash flow estimates yesterday for FY '07 and if we just focus first on working capital, you have done a great job reducing working capital from roughly 10% of revenue down to 7% over the last couple of years. Can you just talk about any working capital targets that you have? I know you mentioned that you're not going to see as much of a benefit in '07 as you saw in '06. Hence why the operating cash flow, while still positive, won't be as positive as it was a year ago. So any metrics you can share either on DSOs or inventory turns?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

I am not going to share many numbers, but let me just put this in perspective for the folks here. Our operating cash flow was $11.3 billion in '06, up from I think $8 billion the prior year and $6 billion or so the year before that. So we have seen tremendous improvements in operating cash flow and free cash flow. I won't bore you with the numbers on free cash flow, but really strong operating cash flow.

I projected a number in the range of $10 billion for '07. So down a bit from our very strong '06. '06 was very strong particularly in working capital improvements. Both '05 and '06 have been very strong in working capital improvements. Both inventory a little bit, DSO a bit more and payable extension, a bit more of a contributor.

If you just look at what we have accomplished, there is a limit to where these things go. You are just not going to bring DSO below a certain level given the kinds of competitive terms that are out there. While we think we can go a little further in payables or we hope we can, we have made tremendous I think six days progress in the past couple of years and we are not going to do another six days of AP extension in the next two years.

So less contribution from improved working capital, but I am still calling for some moderate improvement in working capital in '07, mostly in inventory. We think we have opportunity for platform simplification, supply chain improvements still. We have made great progress on supply chain, but we think there is still more to do. So we think we will get a little bit more out of that, but I am not going to give you numbers.

Brian Alexander - *Raymond James - Analyst*

Fair enough. M&A, and I know a delicate question, but you announced a small deal yesterday, but just talk about your willingness and capacity to absorb another acquisition over the next 12 to 18 months and what parts of your portfolio should people be thinking about in terms of what you might be thinking about?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

Sure. So again, just a little context. If you look at '04, '05 and '06, we spent almost $1 billion a year on acquisitions in those. The biggest one was a couple hundred million dollars of revenue. These were smallish. Some of them had no revenue. A good number of them had no revenue. So they were $50 million, $100 million, $200 million at a crack spending to acquire technology, particularly in our software space.

We just closed the Mercury transaction, Mercury Interactive in November. That was a $4.5 billion cash transaction. So that was the largest cash acquisition I think the Company has ever done. From a cash point of view, as I just indicated, operating cash flow is strong. It's going to continue strong. Free cash flow is strong. We have the capacity to do another large acquisition tomorrow if it is the right thing to do. So there are really no constraints. We can talk about debt capacity as well if you want. So we are strong financially. Strong balance sheet. (indiscernible) do almost anything we want from an acquisition point of view.

But when we look at acquisitions, we look first at the strategic fit, the strategic interest. We look at the financial fit. Financial fit has two characteristics to it. One is the return on investments. Is this a wise thing for shareholder value and two, does it get to a -- accretive -- is it accretive to earnings in a reasonable period of time? Some things being a public company you just have to be sensitive to earnings accretion. And then thirdly, can you integrate it successfully? That one is a tough one. Things get kicked out on that last one sometimes.

After the Compaq merger, we said we are not doing any other integrations. This is such a big bite. We are doing nothing in effect for the next year or so. We did a little bit, but almost nothing. Mercury is a fairly focused acquisition, really only affecting our software business, but it is a tricky acquisition because it is doubling the size of the software business. But if we had another deal in another part of the business that was unrelated that we felt met those criteria, we, like I said, we can do it tomorrow. So there is lots of capacity.

We have focused on and I said again yesterday, our focus continues to be in the services and software space. It may take the form of new technology like Mercury. It may take the form of a new geography or a new capability like the acquisition we announced yesterday morning brings us into consulting integration capability that we didn't have a lot of. So a lot of dimensions that we continue to look at.

We have a large machine that will be evaluating potential acquisitions and they will happen when they happen. Having said software and services, remind you we have done blade acquisitions, we have done storage acquisitions, we have done imaging and printing acquisitions, we have even done personal systems group acquisitions. So I'm not ruling anything out. In all of our businesses, we have a screen of potential M&A targets that is constantly updated and that we are looking at to see if they make sense.

Brian Alexander - *Raymond James - Analyst*

Shifting to geographic trends, I think you touched on it earlier. Maybe we'd see some slowing in the U.S. and we are picking up from folks in the industry that maybe Europe is getting a little bit better. Can you just talk generically about what you are seeing around the world by geography and are you seeing Europe strengthen perhaps because the dollar is weakening once again and it looks like economic growth is picking up?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

So separate timeframes here. So if you look at '06, in fact the U.S. has been growing. My comment earlier was about GDP growth in the U.S. seems to be some slowing. But if you look at our numbers through '06, we're an October 31 count fiscal year, U.S. is actually one of the best growth rates or the Americas was and the U.S. was good as well, while Europe was one of the slowest.

We basically had about 5% constant currency growth in Europe the last several years. So that has been the slowest growing region. Asia-Pacific has been 8% to 10% constant currency range the last couple of years.

Comments right now though are what are we seeing in the economy around us. The U.S. economy is definitely slowing. You see that. Whether it is going to keep slowing or not, I don't know. Europe, we are seeing a little bit of GDP growth above what they have seen the past several years and we are hearing both in terms of IT spending surveys, our own sales force, etc., we are hearing a little more positive signs from Europe. Both enterprise and consumer than what we have seen the past couple of years. So that is all I would say. How that translates into business for '07, we will just have to see.

Brian Alexander - *Raymond James - Analyst*

Before I dig into the segment level questions, maybe we could see if anyone in the audience wants to ask Bob a question.

Unidentified Audience Member

Thank you. I have got a question on the inventory outlook. On kind of a near-term basis, you guys have built up an inventory with strategic buys, going through seasonally stronger periods. What is your view on how quickly we'll see a workdown in that?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

So the question was around inventory levels, strategic buys. I will explain what that is in a moment and what do we see happening as we work that down. So first, if you look at inventory for Hewlett-Packard, you have to understand about half of our inventory is in imaging and printing. Imaging and printing inventory is a very different than PC inventory. Its value does not decline rapidly. We, in fact, never want to run out of supplies inventory. We invest in inventory in imaging and printing and it doesn't have the same risk characteristics that inventory does in some other elements of the business.

We have been, over the last three or four quarters, increasing the amount of inventory, particularly in PSG, but also in some of our enterprise product businesses as well around what we call strategic buys where we have consciously bought more than what the schedule calls for immediately needing.

This comes for two reasons. One, we want to secure a supply. So if you go back into early '06, as we saw notebook demand just growing like crazy, we went and bought some extra displays, got ahead of it and it's served us very well. Allowed us to operate above our plan to meet some of the demand that was above particularly the retail channel plan for notebooks, etc.

We have also found though, particularly as prices have declined and capacity catches up, sometimes you have vendors come to you and say if you buy more now, I will give you another X% discount on what we do. So as '06 developed, more of our strategic buys were in that category where it was strictly buy it now three weeks earlier than you really need it, but you get a discount sufficient to more than cover the financing cost of that inventory. It is not speculative because you have this in your production schedule. So it is just a matter of -- it's a financial decision, a financial procurement decision.

Hard to predict what will happen to the strategic buys. Certainly it is our intent to bring that level of inventory down. But if the deal still makes sense, we will still do the deals.

Another category of inventory that has grown for us this past year is a change in our supply chain. Again, sticking with PCs, we have moved production to China on some PCs because the unit price to us, the unit cost to us is sufficiently lower that it warrants, more than warrants the longer supply chain from China than where we may have been producing it before. So we are making operational decisions to increase the supply chain and carry that inventory. You should not expect that to go down. That is a structural change for the near term. It could someday go down, but until there is a different economic trade-off, that is where we are.

We also have a lot of seasonal inventory. At October 31, we were carrying a lot of inventory to feed the channel for the Thanksgiving and holiday sales period. So I do expect inventory to work down a little bit. We don't really have any inventory carrying concerns. So there are no aging inventory issues. At least there weren't as of October 31. So we don't have any inventory problems, but we are carrying a little bit more than I think under a steady state basis we would like to as we maybe pull the strategic high inventory levels down a little bit.

Unidentified Audience Member

If I could just follow up, (inaudible question - microphone inaccessible).

Robert Wayman - *Hewlett-Packard - CFO & EVP*

No, we haven't quantified it. I would just say it is in the hundreds of millions. This is not $50 million we are talking about. And it is memory, it is displays. Those are sort of the biggest categories that you see these opportunities coming up.

There was another question -- back right.

Unidentified Audience Member

(inaudible question - microphone inaccessible)

Robert Wayman - *Hewlett-Packard - CFO & EVP*

That is where you are seeing the economy. I am not commenting at all on our business beyond October 31. I am just saying what signals we are hearing. Again, when people do IT spending surveys, consumer confidence surveys, whatever, and that is my amalgamation of what often our indicators of demand are telling us at this point in time.

There was another question, I believe, over here.

Unidentified Audience Member

Several years ago, you started [baking] some (indiscernible) distribution networks and compensation and whenever there is changes, there's always anxiety in some of those distributors (indiscernible). How has that worked out? What is happening now and has that been --?

Brian Alexander - *Raymond James - Analyst*

Mark used to be on the sell side.

Robert Wayman - *Hewlett-Packard - CFO & EVP*

I see. Multi-question (multiple speakers). He knows he may never get back to the mic. So the question was around changes at HP has been making -- has made, is making, might make in basically terms and conditions, relationships with channel partners. And indeed we have made some. We were specifically open about some the last year or so.

There is lots of different elements in different geographies in different tiers of the supply chain. But fundamentally, the focus of this is to improve the effectiveness of our supply chain. What we found is that a lot of our channels -- we think of channels as part of the overall supply chain -- I don't know if you use that term as just sort of the in to HP. I use it as both the in and the out to the end customer.

So by channel partners, we are doing a great job. We're getting the kind of marketshare through them the way that we intended to. In other cases, we were getting marketshare in some product areas, but not in some that we felt were appropriate, particularly back to this attach question.

You may have heard Mark Hurd talk about a couple of our partners. They were buying the chassis with the HP name on it and then stuffing it with everybody else's everything else and calling it an HP, but a lot of it was not the kind of stuff that we necessarily wanted to be selling. So to put it in my terms, HP's gross margin on that sale or total margin on that sale was not what we wanted it to be.

So we introduced changes fundamentally to get a better balance of sell-through. The kind of mix of business that would be healthy for HP and hopefully healthy for the partner as well. So we changed some of the incentive systems around attach. You don't get the same compensation if you will if you just sell bare-bones units as you do if you sell them enhanced with certain accessories, etc., etc.

Gone through those changes. It has been beneficial to some. A few have not liked it, but all in all, it has worked the way we wanted it to. We are happier today with our business through the channel than we were before we implemented these changes. They weren't big. But they were noticeable for certain people. Their impact was absolutely not big.

There was talk about no longer doing business with partners, etc. To my knowledge, never happened, but for sure almost never happened. Exactly what business we do with certain partners may have changed a little bit. We think overall, it was the right set of things.

When we talk about terms and conditions with channel partners, this is an ongoing process. We have to continue to respond to the changing competitive landscape both in terms of which partners are doing better and worse in your field, what other OEMs like us are doing with their particular partners. So this is never done. It's never going to be done. We are going to continue to look at what makes sense with regard to the kinds of programs that most effectively drives us to get the kind of business that we want.

I think we are the ultimate multi-channel company. We want our product to be sold in whatever way our customers want to buy it. We want to have healthy channels in all dimensions and that is what we are trying to do. What we're doing right now within the Company is looking, regardless of what the channel is of getting the product there, what is our marketshare with this customer or this class of customers. Frankly, we don't care if it is serviced by the channel or serviced direct as long as we are getting the marketshare that we want in that space. So we want to work with our channel partners to figure out how the best way is to get that marketshare.

Brian Alexander - *Raymond James - Analyst*

We will come back to the audience maybe in a few minutes. Just at the segment level, and IPG new business opportunities, photo kiosk, marketing collateral, industrial printing, when you analyze these market opportunities, can you give us some context into what criteria they have to meet?

In other words, do these new businesses have to fit within the 13% to 15%, now 14% to 15% margin target for that group and as these mature, should we expect that to have an upward bias on overall IPG profitability? Are these more profitable businesses?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

So these are generally new businesses. So it is -- I can't tell you what they will be. I can tell you what our thinking about it will be. But so first to your first question. Yes, the 14% to 15% assumes that there will be elements of our product portfolio that is new business. We will be making investments in those new businesses.

If you look at Edgeline technology, which was an evolution of our SPT technology, we talk about doing a $1.2 billion investment in this over the past almost decade. All that had to fit within the 13% to 15% and the 14% to 15% and as we try to break into these new markets, yes, sometimes you're not going to have the same operating margin. But that is all within the portfolio of businesses.

Fortunately, we have a very healthy core business. It is not growing as fast as it used to be and it is under attack on the supplies basis all the time and increasingly under attack. The point to be made about our printing business -- more and more of the growth -- the printing market is slowing. Even so, more and more of the growth is coming from emerging markets. Protecting supplies share in emerging markets is harder to do because the intellectual property protections are not administered as effectively in those spaces.

So there is a lot of dynamics, but the core business is funding these developing businesses. We expect those developing businesses to end in the same range; not above, not below, but ultimately the mix of portfolios will be in the same range as the 14% to 15%.

Brian Alexander - *Raymond James - Analyst*

In the PC business, historically, consumer has been much more profitable than commercial. Maybe 2X to 3X in magnitude. Is this still the case? Is consumer still more profitable and why? How much would you attribute to the AMD mix, better success with attach, more efficient channel, whatever the case may be? But why is consumer a lot more profitable than commercial?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

So we won't confirm any particular numbers, so I am not speaking to your 2X to 3X, but indeed consumer is more profitable for us. There's a number of piece to this. You have to look at it by geography. If I were at this kind of a session two years ago, I would be peppered with questions about Dell eating our lunch and they are so darn profitable and why can't we make money in PCs and all? Dell is still a very strong competitor despite the changes that they have had. They are particularly strong in U.S. desktop. They are particularly strong in U.S. desktop commercial. That is where their core is. That has always been the toughest part for us. They are probably two to three times bigger than us in desktop, U.S. desktop commercial. So they have got better scale in that than we do. So it starts with that. You've got competitors with certain strengths and all.

If I flip it around to us, we have always been stronger in consumer or retail than the biggest PC competitor, Dell. That is their weakness point. So that is just sort of a given and that is part of why we are where we are.

Beyond that, the dynamics of the PC space have played to HP's strengths the past few years. Again, we weren't talking about this two or three years ago and now you really see it happen. Where is the growth in the marketplace? Notebooks. That is where HP has been strong. Where is the largest growth by channel? Consumer/retail. At least in the last year or so where it has been happening.

And we have said all along that as notebooks become more and more popular, which they have been, as price comes down, mobility needs go up, notebooks become more popular. Notebooks are more personal than desktops. Consumers would much rather touch and feel that thing than they would buy it without, you know, sight unseen. So it doesn't play as well to the Web model or phone-in model that Dell has been so strong in. So that is a lot of what is going on.

Now that has to be combined with and it is a very efficient end-to-end virtually no touch supply chain that we have in our retail notebook channel. ODMs in China, the logistic third-party providers, retail channel warehouses out for the Best Buys and Circuit Citys of the world. We have really good prices, really great products with increasingly design distinctions that are appreciated by consumers, etc. So that is what's behind where we are.

So is that going to go away? As long as those trends keep going, I think we will maintain some of those natural advantages. But I am not naive enough to think that the people down in Texas who we compete with here are happy with where they are. They will be responding in whatever ways they do to try and adjust to the now more evident strengths that Hewlett-Packard has in the PC space. So we will see.

Brian Alexander - *Raymond James - Analyst*

On Vista, a lot of debate in the industry on how much of a catalyst that is going to have for hardware upgrades. Can you just give your views, HP's views on the unit demand you see coming out of this and whether you view that is a huge catalyst and also is it going to perhaps result in some ASP stability because of the richer component mix and have you seen that with some of the units that you have been shipping?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

So we don't expect any huge impact from Vista, but no one knows for sure. I mean they do do surveys and it's clear on the commercial side that CIOs, to generalize, they are not going to be running to upgrade to Vista. They are going to be upgrading to Vista the next time it is appropriate for them to look at an upgrade cycle. They are happy I am sure with Vista, but they are not going to run to it.

On the consumer side, it appears that most consumers aren't impacted by it much as well. We will have to see. As we get into January and it is just around the corner, once it is out there, assuming it gets good reviews, maybe we will get a little demand. Our forecast is assuming that Vista is not a big deal. It is an important deal in the long-term scheme of things because operating systems need to be upgraded, but in terms of buying patterns, we do not predict that it will be a big deal.

We have been shipping Vista-ready machines for several months. That means it has got to have at least a certain amount of memory in it. It is the case that apparently for Vista to operate the way Microsoft would like it to operate, it will need even more memory. So I believe there will, over time, not necessarily February 1, but over time, you will see more memory. That is not exactly a new trend either, but Vista may trigger a little more inflection in that than not, particularly on the consumer side of things.

Brian Alexander - *Raymond James - Analyst*

Any last questions from the audience? Let me just ask one final one on the enterprise business. Talk about the changes you see in servers as it relates to server consolidation strategies and virtualization. You are going through a major transformation yourself in terms of consolidating servers and data centers and if customers adopt similar strategies, is that a good or a bad thing for HP?

Robert Wayman - *Hewlett-Packard - CFO & EVP*

So the context here is we have been talking about the last six, nine months about a huge data center consolidation strategy, moving from 87 data centers to three pairs of two, basically six data centers. A three year, very large investment measured in capital terms. We are tripling our IT capital spend for three years and even after that, it will be substantial. And that is a great question by the way. We get this all the time.

If this is so good for taking IT costs out of HP, which we think it is, won't everybody want to do this and we have got a lot of customers who are saying if you can do this, we want you to do that for us. What does that mean to our business? Are we -- well, one, if we can do this better than others, which we think we can, we can gain marketshare. But I think what has not been effectively conveyed by HP is where the cost is coming out.

The equipment cost is substantial in this and it is not going away. What we are focused on is really efficient data centers with really efficient datacom networks, etc., etc. So if you look at the biggest cost changes that we are trying to achieve, it is in labor cost reduction, huge labor cost reduction, going from 87 all over the world data centers down to six. The operating labor in this is just dramatically smaller because not only do you consolidate and get scale, you put in world-class management tools, [light side] operation. You move your data centers to places where electricity is cheap and you move your data center and negotiate with telecom providers to ways that take your telecom costs down dramatically. Your real estate footprint goes down dramatically.

So there is lots of things besides IT hardware that come out of this and in fact, I'm not going to give you our exact numbers, but IT hardware spend is actually one of the least reductions in all of this. Labor cost is at the high end. Utility costs, network cost, etc. are also contributors here. So it is a complex situation and again I don't think we have done as good a job at communicating this as we need to and we will going forward. We have got to do a better job of explaining this. So that is what is going on.

Brian Alexander - *Raymond James - Analyst*

Well, thank you very much.

Robert Wayman - *Hewlett-Packard - CFO & EVP*

Thanks, Brian.
