FINAL TRANSCRIPT

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HPQ - Hewlett-Packard Analyst Meeting

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PRESENTATION

Unidentified Speaker

Ladies and gentlemen, please welcome Brian Humphries.

Brian Humphries - *Hewlett-Packard - Vice President, Investor Relations*

Good morning, everybody. Welcome to our HP Securities Analyst Meeting. We have a full schedule of events this morning. Plenty of time for questions and answers and presentations and I'm going to be part to bring you through that. I'm going to kick off the event and ask Mark to join us on stage. Mark will be followed by Bob Wayman and Bob will be followed by Shane Robison to give us technology updates which will be followed in turn by Randy Mott.

After that, we'll go to the first Q&A session which will last about 25 minutes. We're going to have a 15 minute break at that stage. Come back in. Ann Livermore will talk about the Technology Solutions Group. Todd Bradley will give an update on his Personal Systems Group and then VJ will address Imaging and Printing Group and then we'll go to our second set of Q&A which will last from 11:30 until 12:00 at which stage I'll ask Mark to come back up to wrap up the event.

At which stage we will then move to an interactive luncheon which is just on the right-hand side of the stage as you're facing me and we will have executives available for questions and answers for approximately 45 minutes. It's a pretty tight schedule this morning. Lots of content we want to bring you through. We feel pretty good about the progress we made in fiscal '06. We're here to tell you we've got more work to do and more progress to make in the coming year and so we're going to be pretty rigid in terms of following the schedule. The event is being webcast live so we will kick off the events at the appropriate times.

Once last thing with regards to Bob Wayman's presentation. We will address a fiscal '08 financial model, both total company basis as well as operating margin and revenue CAGRs business by business. Those slides will be passed out just at the end of Bob's presentation. They will be visible to you on the screen of course during the presentation. You will actually have hard copies once Bob concludes his presentation.

And finally, I'll just point out that there's a wireless connectivity in the room. Just connect to the HP network and you will see it. It's not encrypted so you should have no difficulty logging on.

So with that again, I'd like to welcome to the event and I'll ask Mark Hurd to join me on stage. Thank you.

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

Thanks, Brian. Are you guys pretty excited out there? I could tell. A quick time check. It's 1 o'clock in London, 8 o'clock here and most importantly it's 5 o;clock in Palo Alto. So that's what time I'm on right now. So I'm going to try this morning to talk to you a little bit about HP, give you an update as to the progress the company's made. Let me try to take you through kind of some of the points we'll hit.

Let me do a quick check. How many people were here last year? Okay. And how many people weren't? Okay. So big crowd. Some of the stuff I'm going to talk about in the first chart is going to be a little bit of the repeat on the situation that we were in. I'll tell you a little bit about the progress we've made in '06 and I'm going to tell you a little bit about the market opportunities that we see as a company that we think give us opportunity to scale and grow the company. The resources we're aligning to be able to execute against that growth.

We'll then talk about cost opportunities. I think there's been a belief that with the restructuring we announced on July 19th of '05 that that was the cost opportunity we had in the company. I'm going to tell you today that there is more and that there is significant leverage that remains in our model if we execute as we just described.

Let me tell you a little bit about 2006. Now the first part of this chart really is the exact same things that we talked about a year ago. For those of you that weren't here we talked about -- I talked about the situation that I found at HP. Not all of great. At the same time, not all of it bad by any means. But here were the issues that we are facing and then talk a little bit about the things we are going to do and here's a bit of a progress report and I'm not going to take you through every detail on this chart, but first operationally.

We have eliminated three full layers of management from the company over last year. So we worked very hard. We talked last year about management having both depth in terms of numbers of layers of management and breadth in terms of number of matrices you have, i.e., number of people that can touch a decision. And over the course of our restructuring we've eliminated three layers of management, therefore shrinking the depth. And we have eliminated about 50% of our matrices at the same time, therefore decreasing our width and as you decrease a circle around those you become faster, nimbler, you eradicate cost from your model and in my opinion the company performs better.

As soon as our results improved we grew in dollars, $5 billion in terms of growth last year. Our non-GAAP EPS was up 47%. Importantly, we had a more balanced profit mix across our businesses. Historically, IPG has produced a large percentage of HP's profits. IPG's profits increased, yet the percentage of HP's profits that IPG produced decreased significantly as a percent of what HP delivered. Morale improved in the company. We've hired significant numbers of sales people. Redone a lot of work on our channel program. Put a lot of focus on our attach programs which are again commensurate with us being able to improve our margins.

That said, we have a lot more work to be done at HP. We have to execute consistently. We've been able to start to show some consistency in our ability to deliver on our commitments. We have to continue that. We need better capital allocation. We have a lot more cost to take out and we have to become as efficient as possible. We need to make HP easier to do business with and you're going to hear me talk about this this morning. Improve our sales effectiveness. So I characterize '06 as an important year but for us I said inside the company I'm going to say to you, we're a company that is transforming. We are not a company that is transformed. So we have a lot of work left ahead of us.

Now you might remember this chart from last year but I get questions all the time if I make funny charts just for meetings like this and never use them again. We use this chart in the company all the time and the core message we try to use with this is the fact that we're trying to do multiple things at the same time. We are trying to grow our revenue. We are trying to do that while we focus on efficiency and costs. So for example, in the company we talk a lot about the fact that when we take out cost we literally enable ourselves to grow. The fact that a floor of a building being shut down literally allows us to put 14 sales people on the street and actually produce gross margin for the company and help us scale.

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The inner connection between those levers is not just as important thing from a financial perspective but it's a very important thing for operating people in the company to understand and be able to interconnect these points. We have a lot of opportunity to improve but our objective and our strategy is to establish Hewlett-Packard as the world's leading information technology infrastructure company and here's what we're trying to get done.

First, we're trying to drive highly differentiated technology and services so at our core we are a technology company and we operate with the services around that technology. You won't see us drifitng off into non-technology areas. Services to support the technology and those technologies and services have to be highly differentiated and we have to turn those into solutions to help our customers solve problems.

We have to be able to capture the market opportunity with a quality sales coverage model and for us that means leveraging our hybrid channels which we think is a strategic advantage. The fact that we can improve our ability to cover more accounts with more HP resources. The fact that we can, in driving our source channels, our reseller channels to cover accounts and give us yet more coverage. Leverage our retail channel partners, be able to leverage the web. We're going to talk about the total addressable market that we can serve and it is large and we need to be able to cover that market and basically try to get to all the buying points on the planet as efficiently as possible at the lowest unit cost.

At the same time, we have to drive customer satisfaction with superior service. Everything we do has to end in tremendous service for our customers so that we can get repeat business. And you're going to hear us talk a little bit about this today or I'm going to talk about it that we have to take our scale, that year ended at 91.7 billion and drive that into the lowest unit cost in the industry; that our scale has to be a competitive advantage for us to be able to improve our competitive position in every market that we compete in. So that's what we're trying to do.

Now we think we've got a pretty good understanding of customer requirements. We think we know what they want. We've looked at markets in context and I'm going to talk about them in a second between consumer, small and medium business, the enterprise. We think in the enterprise, people want lower IT costs. I wish it was as simple as that. People want lower IT costs at the same time that they strive for better information. They want the best information in their industry to be able to compete. At the same time, they have to be able to run the company and, if you will, lower their operational risk. They at the same time want to have people that go more mobile, more wireless. We have to be able to help them support that.

Small and medium business is a hybrid market. Some of the high-end of small and medium business behaves more like the enterprise. Some of the low end of small and medium business even behaves more like a consumer. The consumer continues to tell us they want simplicity. They want ease of use. They want things that are insanely simple to use. They want to be able to use things at home. They want to use them on the go and they want to be able to have that operating experience to be seamless as they move. And in everything we do from a customer -- study we do from the customer requirements' perspective, service and support continues to rise in terms of its importance in relationship to the requirements of each of these segments.

Now this translates to us into a huge revenue pool of opportunity for us in addressable markets for HP. TAM, which stands for total addressable market is roughly $1 trillion for us in 2009, so after a careful analysis we've determined that that is big. We have looked at this opportunity multiple different ways. So, for example. we look at internally in relationship to PSG, IPG, PSG TSG, et cetera. At the same time, we try to look at the market relative to consumer, SMB and enterprise as we described earlier but it's also important for us to look at emerging markets versus mature markets.

Emerging markets have very different characteristics from mature markets. Emerging markets typically have GDP faster growing than mature markets and IT growth in some cases double that of GDP. And in most cases scaled IT companies like Hewlett-Packard have a chance to grow even faster than IT rate because the local IT ecosystem is not mature and developed. So for us, understanding those dynamics is critical to our success. So we think we've been able to look at these markets in multiple different ways. I would say, we put as much analytic behind this as we have our costs and we've put a lot of analytic around our costs.

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And we think we have growth initiatives that are significant and for us, it's not just about the compounded annual growth rate of this total addressable market. It's about the share opportunity we have within this total addressable market because we believe the market is moving with trends that are supportive of what we can do for customers. And we think we think we can not only participate in it, but we think we can lead it and drive it. So for us, it's very important not just about the size of the market but our ability to [share].

One example would be an enterprise print. VJ's going to talk about this later this morning. Enterprise print is a couple of thousand biggest accounts, $70 billion market. Bigger than that when you get to 8 to 9,000 accounts. That market is not growing significantly. It's made up of faxes, copiers, single function printers, services around it. In fact, services is 45% roughly speaking of the market. But the market is morphing towards our direction. It's morphing from faxes, copiers, and single function printers to multifunction printers.

We think we have the best technology on the planet. We think we have the right collection of services, ESS infrastructure enterprise servers and storage along with our IPG technology and services delivery capability remote to capture share at the same time as we grow with the market. So again, very important for us to not only look at the compounded annual growth rate but the total addressable market, the solutions we can bring to the market, the growth we can generate and share that we can gain. So for us, significant opportunity.

Big issue for us to realize that opportunity is our ability to be effective when we see the customer. For those of you who don't know the history of HP and I've been here not quite two years this is -- however much technology you think is in HP, there's more. We have technology all over the place. We have great technology in the company. We have a tremendous culture around services and our ability to deliver service to the customer. We are great at those two competencies.

From a sales perspective we have work to do. We actually have had a theory in the company, I think that for a long time, that if we build great technology customers will find it. And it sort of works. We've got a new advanced theory that if we actually try to sell the stuff, we'll actually get more revenue. So we're working - that was a joke so you're supposed to laugh. I can tell you're not -- or it's too early for all of you, but we are trying hard to beef up our sales capability.

And for us, it's all about following the traditional steps of building a sales model to define and segment our market. We believe we have done that. We believe we are doing that. We still have more work to do but we have made progress. The market is different by geography. It's different by solutions set. It's important for us to understand those differences.

We need to make sure we have the right number of people in the right place at the right time. We have made significant progress in hiring. We still have more yet to do. We have to make sure we have best in class training programs that allow us to not only show up at the customer, we show up able to solve the customer's problems and the more we can solve those customers' problems, the different perspective our solutions and our margins make. So for us, it's all about getting that done and then enhancing customer loyalty as we do it and at the end of the day being able to solve customer's problems, driving customer loyalty increases the share of wallet into repeat business. This is hard work but we will get this done. We will build the competency of go-to-market and sales as one of the strong competencies of Hewlett-Packard.

Now let me talk about costs. I have had various meetings with shareholders and I only bring this up just so that I make sure I have all clarity about costs and I'll say specifically how I think about costs. We've had a discussion. Shareholders told me that they've looked at our operating expense and think we've been pretty efficient with OpEx so we must not have a lot of cost left in the company to go look at. I say really, "That's how you look at, that's interesting because that's not how I look at it.

To me revenue minus operating profit equals costs." So for us, we have after last fiscal year $84.3 billion worth of costs. So if you think we're 90% efficient -- I'm not trying to give you a number, lease don't write that down and print it --We'd only have $80.4 billion worth of inefficiencies. If we have 5%, we'd obviously have $4.2 billion worth of inefficiencies. We have significant opportunities to improve.

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Now we are zero based budgeting everything. We deal with granular forward-looking benchmarks and I want to make sure it's clear because I've heard a lot of people talk about benchmarks and I want to make sure you understand. Gathering benchmarks from companies a tenth our scale of what they did in 2004 and trying to operationalize that in 2006 to bet where you're going to be in 2008 is not a good plan. So we spend our time trying to understand what the most highly scaled, biggest company in the industry should look like, could look like in 2009 against benchmarks and basically targets that we set that give us a competitive advantage. First of all, we're not there yet.

I've also heard the comment that I want to comment about, companies that might get tough in the market. What if XYZ company decided to get aggressive in the marketplace. Most of the people that respond to who XYZ is are companies that are more efficient than we are today. And I actually would reverse the question, that if we execute the plan we're on what will happen if we decide to get tough and we will get more efficient.

So for us, I want to make sure you're clear that we do understand our cost now much better than we did a year ago. We understand our real estate costs, which we have too much of. Per employee, we know about it worldwide by region, by business group, by unit, by site. We have big opportunities. We know IT costs by employee, by site. We know it by function. We know our costs of logistics by box, by unit and we can decompose it within the context of the $84.3 billion, in addition to our costs of delivery for service, whether it's costs coming out of the data center by unit cost or whether it's our labor costs, et cetera.

So for us, we will continue to push. The good news and bad news for us is one and the same. It depends who's view you're looking at. We have too much cost. The good news is we have cost that we need to rid ourselves of. The bad news is we still have to go do it. And for us it turns into an operating model that basically looks like this. Bob is going to give you some views of 2008 of 4 to 6% revenue growth and when I present that it sounds relatively benign, 4 to 6%, not a big range.

But if you do the three year compounded annual growth rate, by the time you get to 2009 and add in 2006 plus our acquisition of Mercury, the difference between 4% compounded three times and 6% compounded three times is over $6 billion. So one question you might have and I'm not trying to stir you up would be which is it? And so for us we clearly have to make sure that we execute around the growth initiatives that we described earlier.

For us, that means sales coverage. Sales coverage isn't just humans. It's sales coverage all the way through that total addressable market, leveraging our partners. Our partners can get to places we can't get to fast enough with a "direct sales force." It's leveraging our retail channel partners so we can get to those consumers. It's leveraging everything in the ecosystem across the planet to try to get to every piece of that total addressable market. We will do targeted M&A although I would not -- you should not expect us to be doing huge acquisitions.

That is I'll never say never to anything. Clearly, we did the Mercury transaction. You noticed we made an announcement today, but again, you should think of the acquisitions that we will make as ones that will follow three criteria. Do they strategically make sense? Do they financially make sense and do they operationally make sense? Meaning that we can operate them and we can run them effectively and we will follow that discipline as it relates to mergers and acquisitions.

Cost initiatives. We've got them. We need to execute on them and again we are transforming as opposed to transformed. We had more cost work to do. The mix of that growth as it relates to gross margins is important to us. So if we get 4 to 6% growth and it's the low end of the high end, it's probably just as important of what growth did we get as opposed to just how much growth did we get and we are driving hard on attach. Attach is critical to us. It isn't so much about whether we deliver something direct or indirect. It's about how much of the basket gets attached to what we sell at the point of transaction and you'll see us continue to drive on those attach programs. We've made progress but a lot more to do.

I've talked a lot about costs. We'll maintain strong rigor on our cost structure. We have reduction and we have come in with a relatively big overhang a couple of years ago. That had to do with our stock price being low. A lot of grants. We are reducing our stock options. We've been aggressive on our share repurchases but you should expect us to have a disciplined capital allocation strategy. Bob will talk about that more.

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You'll see us continue to optimize our core. You're going to hear a lot about that today. VJ, Ann and Todd all talk about making sure that we support our core but at the same time we look for sensible adjacencies and realign our costs so that we can spend more time on growing. Get rid of every inefficiency that we have across Hewlett-Packard. Either align it to the bottom line and give it the shareholder base or turn it into growth that can produce yet more value to the shareholder base. And we'll continue as we've said to leverage our balance sheet prudently and appropriately.

So in conclusion, I think we made good progress in '06. I am pleased overall with our progress in '06. The market trends I think play to our strengths. I think we have an opportunity to not only play on those trends but to lead it and to drive it. We'll align resources to invest in growth. There are more cost opportunities in HP and I must say that's probably one of the things that surprises me the most that made a one-time restructuring announcement and everybody believes, boy, you must be efficient now. I wish it were that easy. I wish it were that easy. We have more work to do.

We're committed to execute with discipline. I think the discipline in the company is up. The clarity of operations is up. I think our commitment to deliver is up. That said, we still have a lot of work to do. I would tell you that if we execute on our initiatives there is significant leverage left in our model that we believe we can drive forward and I will tell you that we do focus on delivering on shareholder value in most every discussion that we have across the company.

So I'm going to stop there. I'm going to invite Bob up. Now Bob, as you know yesterday announced his retirement for his multiple attempts here and this one we think is going to stick because we announced Bob's successor yesterday and I wanted to take a second to introduce Cathie Lesjak. Cathie's in the front row. Cathie if you could stand. Cathie is our CFO and will be effective January 1.

But Bob, I'm not going to say goodbye to Bob right now because Bob is still the CFO and will be until January 1 so Bob's going to come up and take the filed but I'd be remiss if I didn't take the opportunity to thank Bob. He has been tremendous for Hewlett-Packard across his entire career. But frankly, tremendous in his support of me during the time that I have been at HP. I mean it's been a real pleasure to have Bob and his support and I want to take this opportunity to thank him.

So without any further ado, Bob Wayman.

Bob Wayman - *Hewlett-Packard - EVP and CFO*

Thank you, Mark and good morning, everyone. Nice to be here again. I think this is about my 40th Security Analyst Meeting over my career so I'll try and do this one right. Okay. Quick look at my agenda. We'll look at the full year '06, just hit some of the highlights. Make sure that we all have a common understanding of what we accomplished in '06. Look at some revenue trends by region, some profit trends by segment. You'll be hearing more about that from the business folks later in the morning but I'll give you my view.

'07 outlook. Now this is just a restatement of what we said several weeks ago, but just to make sure we have a common ground on what we have said about '06. And then focus a bit upon a preliminary FY '08 operating model. Talk about the balance sheet, cash flow, tax rate, a number of other items that I think all of you have to feed into your models, not only talk about recent trends historically but in most cases give you some idea of what you might expect coming forward on some of those key items. And then finally, a few comments on capital allocation.

So here's a look at '06. Revenue $91.7 billion, up 6% on a reported basis. Up 7% on a constant currency basis. I'll show you some region breakout of this in a moment. Gross margin up 0.009% to 24.3% of revenue and virtually all businesses showed an improvement in gross margins during the year. OpEx up 1% year-over-year. Compared to the 6% revenue growth, that's a very nice 5 point spread between revenue and OpEx growth. OpEx as a percent of revenue down 0.008% to 16.2% of revenue.

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And operating margin, you can see the numbers there, up 32% and do keep in mind that FAS123-R was implemented in '06. We did not restate '05 so profit growth is even greater than that. If you look at EPS growth, up 47% as reported and there are really two offsetting factors behind that number. One is FAS123-R, as I just mentioned. The other was a tax settlement that was worth about $0.15. If you adjust for those two items, earnings per share was up 53% year-over-year.

So here's a look at some revenue and profit trends for the total company. First, the blue bars represent billions of dollars. The yellow line as reported and the red line on a currency adjusted basis. As you can see, revenue as reported growth rate slowed down in '05 and '06 but when you look at it in constant currency, in fact, we've had a steady growth in our growth rates of revenue.

Non-GAAP EPS accelerated nicely the last couple of years after a 22% growth in '05. A 47% growth, or as I said a moment ago, 53% when adjusted for those items that are mentioned. So very, very healthy growth in earnings per share.

Here's a look at revenue by region the last several years. First, looking at the Americas on the left, we see steady improvement in growth rates on both a reported and a constant currency basis, 9% reported, 8% constant currency. Latin America very strong within this but both the U.S. and Canada doing well as well. EMEA, definitely decelerating on a reported basis and roughly flat at about 5% constant currency the last several years. Asia-Pacific, a little slowdown as well on both reported and constant currency. You can see 7 - 8% kind of growth in Asia-Pacific on both those bases.

Quick update on recurring revenue. I give this to you every year. Not much change. Supplies up just slightly to 17% of total company revenue, support and managed services together down just slightly but still at 14% of total company revenue and HP Financial Services at 2%. So total recurring revenue at 33% of total company revenue, relatively unchanged the last several years. But this is a good outcome. It gives us some element of stability to our revenue stream.

Okay, one of my favorite charts. Five year trend in our business segment profitability. Bars represent millions of dollars of operating profit. Line chart represent operating profit margin. So starting in the upper left, PSG 3.9% operating profit for the full year and a $1.5 billion improvement over the years shown. IPG, record level of dollar operating profits and a very healthy 14.9% operating margin. ESS 8.4% operating margin.You can see the nice improvement here. That represents almost $1.7 billion change in operating profit from '02 to '06.

Services. A new high in operating profit dollars, 9.6% of revenue $1.5 billion for the year. Software, our first profitable year at 6.5% so a really fine outcome. A $400 million turnaround in the years shown for software. HP Financial Services. Just an okay year at 7.1% operating profit. Down from last year but last year was helped by the reversal of some accruals that we took in '04, reversed in '05. So about an average year of profitability for HP Financial Services. So I think really quite a nice portfolio of results when looked at by segment.

This is a different look at segment profitability focused on the balance of profitability. Looking at '03 to '06, using ESS as an example to the far left. You see that ESS at 1% margin represented 3% of the segment operating profit dollars. In '06, at 8.4%, they're at 18% of the company's profitability, a 15 percentage point improvement as a share of the total. HPS down a little bit from 28% of the total to 18 but that's because fundamentally they've been a pretty steady performer and turned in again a very nice profit outcome at 9.5%, but down 10 points as a share of the total.

Software, you get the picture. Minus 4 to plus 1. It's a 5 point change. IPG still very, very healthy turning out wonderful levels of profitability but down from 74% of the total company profit to 49% and PSG from zero up to 14, 14 point improvement. So IPG and services down but very, very healthy levels. The real change, of course, is in the other elements where they have shown substantial improvement in profitability and that leaves us with a healthier, more balanced portfolio.

Okay, before moving to a preliminary look at '08, just to remind you what we've said. 97 billion in revenue including Mercury. Mercury, of course, closed in early November. GAAP EPS of 228 to 233. Non-GAAP EPS from $2.48 to $2.53 which includes about $0.04 of dilution from the Mercury acquisition. So no change here. Just to remind everyone what our current guidance is.

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So let's look at a preliminary FY '08 operating model and these next two charts are the ones you do not yet have in your packets. They'll be passed out shortly. First, on this page we'll look at the total HP level and it shows a range of potential outcomes. 4 to 6% revenue growth with 5 being the midpoint. We assume here in '08 constant currency year-to-year and we assume modest levels of acquisitions. The kind of acquisitions that we have done periodically but nothing substantial. That would translate into revenue in the range of 101 to $103 billion. We're looking at 9 to 9.5% operating margin. I won't read the operating profit numbers to you. You'll get that in your packet.

Talking about other income and expense in the range of 500 to $600 million of income. A tax rate of 21% and I'll come back, I have a chart on taxes in a moment. I'll explain more about that. Weighted average shares. Again, I'll comment more about in a moment in the range of 2725. That is 2.725 billion to 2.750 billion shares. A lot of uncertainty around what the share count will be and again, I'll come back to that in a moment and importantly you see the lower share count combined with the lower other income and expense. The higher share count with the higher other income and expense which is logical given that it depends upon how much cash we use to drive share counts and how much cash would be available to drive interest income.

And all that translates into a EPS of 2.88 at the midpoint ranging from 2.78 to 2.98. Again, this is preliminary '08 full year. As you know, we have seasonality by quarters and you will see deviations by quarters but that gives you our best look at an '08 model for the total company.

We go to the segment detail. The first column of numbers shows our expected revenue growth. PSG, IPG, ESS and HP Services are all the 4 to 6% range. Software at 10 to 15% revenue growth expected and financial services at 6 to 8% revenue growth. Second column of numbers is operating margin. With PSG, we're expecting to be in the 4 to 5% range. IPG, 14 to 15%. ESS, 9 to 10. Services, 11 to 13. Software, 18 to 22 and Financial Services, 6 to 8%. That's our current update. Again, these are full year expectations. You will see some numbers by quarter outside of these ranges but this I think what's most for long term planning purposes.

So let's look at some other variables that go in to affecting our numbers. Let's start with tax rate. Here you see a three year history as well as two years of projections for '07 and '08. Our tax rate projection for the past three years, '04, '05, and '06 was for 20% and as you can see in this chart we did better than that in each of these years based upon various items that are noted. In '04, a state tax resolution which had a favorable impact. In '05, litigation which had some tax rate impact as well as some other audit settlements. In '06, a substantial settlement with the IRS for '96 to '98 years. So important to keep in mind, we've only closed '98. We've got a lot of years open and we will continue to see some adjustments as we close audits going forward, at least potentially we will see that.

We expect a 20% rate this year in '07. Expect some pressure on the upside in '08. What's really happening here is with our improved profitability, the mix of our profitabilities is changing and we expect to continue to change. That mix will result in certain segments of business, in certain geographies to be different than what we've seen in the past few years and there's a bias towards higher tax environments as that mix of profitability changes.

Stock-based compensation. Now we had a $0.19 impact on EPS in '05. That is it would have been had we restated, which we did not restate, but to give you a sense of the trend of the impact of stock-based compensation, $0.19 in '05, dropping to $0.13 in '06. We expect it actually to go up a little next year to about $0.14. This is despite the fact that option issuances have gone down and we expect them to continue to go down. But that trend is more than offset by the higher stock value which translates into a higher fair value under the Black Shoals method as well as somewhat higher volatility that we have seen and expect we will see in '07 as well. Again, both of those pushing up the fair value calculation that drives the amortization of stock-based compensation.

Very complex chart on share count but a lot going on here. It's very hard, I think, to understand and even harder to predict where our share count will go. Let me start with the upper left-hand part of this chart which looks at basic shares outstanding. '03 to '06, the top line shows the beginning of the year share count from about 3 billion shares down to about 2.8. Next line shows share repurchases. You can see it's moved up from 40 to 223 million shares in '06 epurchased.

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At the same time, issuance, mainly stock option exercises. Issuances have gone up substantially from 39 million to 118 million shares. The issuance has been broken out at least for the stock option portion of issuance which is the vast majority. You can see by year, it's gone up from 13 million shares to 101 million shares and importantly by quarter for this past year. You can see the volatility here ranging from 17 million to 37 million shares exercised by quarter.

Now move back to the left-hand side -- the lower left-hand chart now looks at the averages of shares outstanding, first on a basic share count basis in the top line. I won't read the numbers to you. To that we have to add common stock equivalents which takes into account -- in the [money-ness] of vested options. You can see that number has gone up substantially from 16 million to 62 million common stock equivalent.

Next chart is the adjustment for the convertible debt, small and unchanged at 8 million shares a year. And that then brings us down to the fully diluted share count shown there in the roughly 3.1 billion share count range down to 2852 on an average basis for '06. The next line, I've shown options outstanding. Options outstanding went up in '04 and now has come down nicely in '05 and '06. The chart on the lower right breaks that out in first the bar chart being the options outstanding and then you can see the big increase in issuances through option exercises and the decrease in the share count on options as well. So that results in option overhang of 16.4% at the beginning of the period, up to 18.9 and now down to 16.3.

The big variable here of course is how many shares we buy back offset by how many shares are exercised. I'll talk about share buybacks in a moment. Very difficult to predict exercise patterns. Obviously, price plays a role, vesting plays a role but individual circumstances and employee psychology plays a role and that's what we really cannot project for you going forward.

Then move to working capital. This chart shows for inventory, receivables and payables where we were at the end of '04. Where we were at the end of '06. The actions we've taken and what we're working on going into '07. So starting with inventory. 39 days down to 38 days. We've seen some SKU reductions curing that period of time, trying to simplify the product line. We moved to more low touch and even no touch supply chains. That has helped. At the same time we've made some production location decisions which have actually added to inventory, intentionally added to inventory.

We've opted for a lower procurement costs of products and parts offset by somewhat of an increased supply chain. Net, net the company's better off for a total lower cost but it does add to inventory. Likewise on strategic buys. In some cases, we buy inventory ahead of when we really need it if we get a really good price from a vendor. Going forward, we continue to work on supply chain optimization. We have further platform simplification underway, we expect to see some benefit from that. And at the same time we will continue to look at production locations and strategic buys.

Receivables. Very nice outcome here. Moving from 43 days down to 40 days. We've seen improved aging. Very active collection efforts underway and we've seen some improved linearity of shipment both within the month and within the quarter. We've brought it down to 40 days. Going forward we're going to work on maintaining our really excellent aging situation that we have today. We've implemented new collection systems on a global basis, which we think will improve both the efficiency and the effectiveness of our collections, but at the same time we are seeing pressure from our customers for longer terms and in some cases we think that's the best thing to do. So we have some P&C pressure pushing upward on DSO.

Payables. A great story here going from 51 days to 59 days. We have been in active negotiation with our suppliers to get better terms and conditions and we will continue to work on that going forward.

Cash flow. Another busy chart but really quite a nice set of numbers. First row, cash flow from operations moving from 5 billion to 8 to 11.4 in '06 and we're expecting roughly 10 billion in '07.

I'll only comment on net CapEx. You can see CapEx in general has been increasing up to 2 billion this past year and we expect about 2.1 billion in '07. That results in free cash flow moving up from $3.4 billion to 9.4 in '06 and we're expecting about 7.9 billion in '07. Included in this, contributing to these outcomes you can see a couple of items that I think are worthy of some note. Pension contributions have declined nicely into '06 and we expect it to decline further in '07.

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Restructuring. Now we've accrued restructuring. This represents just the cash payouts associated with those restructuring actions. $810 million of cash utilized in '06. We expect that to drop to about 550 in '07 and then drop to almost nothing in future years.

Importantly, when looking at '07 modeling of cash flow, we have a substantial bonus payout which will occur in Q1. So we will see an impact on Q1. Q1 cash flow will be weaker than normal and it's a big enough number that it effects the whole year when you put all the quarters together as well and we are expecting modest improvement in our overall working capital metrics next year.

Here's a look at our cash balances both gross and net. Gross going from 13 billion up to 16.4, net from 5.9 up to 11.2. We currently have about 5.2 billion - currently at the end of October we had about 5.2 billion in debt outstanding. I think you all know we tend to build up cash outside of the U.S. and end up borrowing in the U.S. occasionally to support our US needs.

We want to have a certain amount of debt to support our finance company operation. The finance company has about 7.2 billion in net assets. We'd like to leverage that about 6 to1 and so we should actually have slightly more than 5.2 billion debt to meet that goal. Generally, I believe that HP has quite substantial capacity to finance the investments that we need to do in the coming years. Lots of cash outside of the U.S. and a lot of debt capacity here in the U.S.

This next chart simply portrays the cash outlays that we've seen for acquisitions in the past three years and first quarter of '07 is averaged a little under $1 billion for '04, '05 and '06 and now of course 4.5 billion for Mercury in Q1 of '07. As Mark indicated, M&A decisions designed around strategic fit making financial sense. That means both a good return on investment cash on cash investments as well as accretive to earnings in a reasonable period of time. And we want to do acquisitions that we had high confidence that we can successfully integrate.

Our '07 priorities of course include the integration of Mercury and we'll continue to focus our M&A efforts around services and software, which is where you've seen most of the activity, but keep in mind that we have done transactions around blades, around storage, around IPG, PSG, so it is the whole portfolio of businesses that we will occasionally support with inorganic investments.

Stock repurchase and dividends. Multi-year chart, let me start with dividends. Almost $1 billion layout for dividends in '03. A little under 900 million by the time we get to '06 as we've seen the share count go down. Share repurchases, 751 million up to 3.3 billion to 3.5 billion in '05 and now 7.1 billion in '06. We will continue with our share repurchase program to offset dilution and to reduce share count opportunistically when we believe it makes sense.

We have been maintaining and expect to continue to maintain our dividend payout and we'll periodically evaluate whether that is the right payout on a going forward basis. And we will of course keep an eye on our cash usage for both dividends and share repurchase in light of our needs for cash within the business. So in talking about capital, obviously, we've had a lot of focus on generating capital and we'll keep that focus. In terms of utilizing capital, our first priority is to invest in the businesses. That takes the form of capital expenditures for both growth and efficiency.

We spend capital in IPG to build supply line as new products, new supplies come out we have to invest to make that happen. Managed services space, data centers that we operate on behalf of our customers consume capital and in financial services use capital to support that business as well. In the area of efficiency, you'll hear certainly from Randy later, the data center strategy. Big user of capital in the short term to drive costs down in the medium and long term.

Same with our real estate efforts. We are consolidating our real estate footprint. To do that we're going to have to spend some money to take costs out of the system. We'll use capital within the business to drive growth. We'll invest in R&D. We have been and will continue to. Shane will talk a bit about that in a moment. Go-to-market investments, sales force capacity increases and market investments. Go-to-market investments in commercial activities et cetera driving organic growth. And then, of course, as I just mentioned, inorganic growth, M&A activities support inorganic growth as well.

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So the first priority we invest in the business. After that, we will return to pass to shareholders just as we have in '06 through dividends and share repurchases. In '06, a total of $8 billion returned to shareholders through these two mechanisms.

So finally, quick summary. Solid revenue growth this past year, 6% reported, 11% constant currency, added $5 billion in revenue. Healthy recurring revenue, a third of the revenue is recurring. Much improved balance of profitability. All segments profitable for the first time in a long time. Strong EPS growth, 47% as reported, taking into account the adjustments I mentioned, actually a stronger 53%.

Significant cash flows and a strong cash position, 11.3 billion operating cash flow, 9.4 billion free cash flow. And with that substantial investment capacity to take these businesses forward on a healthy basis. Doing all this we have been and will continue to return values to shareholders through improved business performance and the cash generation that comes with that and through share repurchases and dividends.

So thank you all. That concludes my remarks. Shane's next, but we're going to start with a video so roll the video please.

[VIDEO PLAYS AND RESUMPTION OF SESSION]

Shane Robison - *Hewlett-Packard - EVP, Chief Strategy and Technical Officer*

Good morning, everyone. Hopefully, that video drives home the point that Mark made earlier which is first and foremost HP is a technology company. But maybe more importantly we're actually having fun building the foundation for growth for the company. We've done a lot of work in building best practices in the technology community this year. Technical career paths, a lot of development opportunities for people across the company and TechCon is one of the highlights.

We do that annually. It's a spring conference where people come together. It's intensely competitive to get there and this year we kicked off another one. I just got back from Asia and we have a TechCon Asia for Asia in Asia and it's just started. This is the first one and it's the same type of conference. The difference is a lot more focus on the automation technology that we use to more efficiently and effectively deliver services.

So one of the things Mark mentioned earlier is our goal is to build the world's leading information technology infrastructure company. So I want to add a footnote to that which is we're in the field of broad definition of information technology infrastructure. We think about it in the context of the enterprise, small and medium business and consumers. And we have a broad definition of information. It's more than just the traditional information that we all use in our businesses. It's rich media. It's video. It's audio. It's printed material. It's digital still photography. So a fairly rich definition. Using that I'm going to give you a glimpse of some of the technologies that we're working on internally.

What I want you to take away is there's lot of differentiated technology inside HP. You're starting to see that come out in the presentations. You'll see a lot more in the presentations this afternoon. One of the things I'm going to focus on is to give you an update on how much we've aligned our technology strategy with our growth strategy so everything we do is in the context of the growth opportunities that Mark talked about. And our technology is giving us a competitive advantage. So people talk about stickiness. Most of this technology is going to give us the ability to grow both top line and bottom line over time.

Mark talked about the technology trends starting with the customer requirements. On the left-hand side here I've kind of reiterated that. Three of the major market opportunities that we talked about earlier are in the center; digital imaging and printing, "always connected" mobility and next generation data center.

There are lots of key technologies that you have to have in order to competitively take these marketplaces. I can't list them all here. You could see from the TechCon video that there're literally hundreds of programs going on throughout the company. So what I've tried to do is categorize them so you can get a feel for the types of things that we're working on. In printing and

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imaging, it's really about having multiple print engine technologies and scalable print engine technologies. And it's also about having technology that helps us deliver managed print services more efficiently and more effectively than anybody else in the industry.

This "always connected" mobile experience is not just about devices. We have lots of devices. Todd will talk a lot more about that, but it's also about having the platforms where we partner with the service providers and the content providers that enable us to really deliver this new experience. So things like our service delivery platform and our digital media production pipeline.

And then in the next generation data center space it's about modular service oriented architectures, blades everywhere, holistic management of the data center environment and delivering all that through managed services and technical services.

So now I'm going to zero in on a few technologies and I want to make the point that these are just a few examples. I couldn't possibly touch on all these so I want to go a little deeper just to give you a feel for some of the things we're doing in the context of each of these growth trends. So in each one I'm just going to pick one example. We'll start with scalable print technology and then in the "always connected" space, I'll talk about dynamic transcoding and in next generation data center obviously, one of the big problems is managing power and cooling and I'm going to give you a little more detail on some stuff we're doing there.

These diagrams give you a feel for the complexity of an individual nozzle in the print space. So our engineers a few years ago started to look into the future of inkjet printing and we took inkjet printing all the way back to the drawing boards. We looked at new writing systems, new inks, new printhead materials and new fabrication process and after a six year $1.4 billion R&D and manufacturing investment, we introduced scalable printing technologies.

So scalable printing technology just to give you a feel for what it can do for you allows you to put more nozzles close together on a printhead. More means 10,580 nozzles on a single printhead. That's 5,280 per color. There's multiple colors. It varies depending on the category, so for consumer it's a little different than for the enterprise. And to give you a feel for how densely packed these are, there's 1,200 of these nozzles per inch in linear printhead. So based on our scalable print technology, our consumer photo printers are the fastest in the world. So we put out the highest quality 4x6 prints about every 12 seconds.

But more importantly, we've been able to take that scalable print technology and take it into commercial use. so, in our retail photo kiosks, we can do those same very high-quality 4x6 prints in about every five seconds. So high-quality, low cost and high speed. So our new Edgeline printing system will allow us to extend this technology into the enterprise. You'll hear a lot more about that from VJ. You'll see a video on it later today and now I'm going to shift to "always connected".

In the "always connected" space, one of the things that we as an industry and in particular, we as HP have gotten really good at is connecting devices to the network. Our iPAQs for example have more radios in them than any other product in the industry. You can connect to any network, personal area, wide area or local area network or multiple network. So we're pretty good at that part. We think the next wave of innovation is going to come from connecting content and users or content to new user experiences and in that context we sort of have three different ways that we think about it in TSG R&D.

One is this sort of lean forward, which is your traditional either desktop PC or laptop PC experience in the office or at home. Another is lean back which is more of an easy chair experience with one of our smart TV products. The other is walk up which is a kiosk experience. You may have that in retail or you can even have it in your kitchen with some of our new touch screen products. And then on the go is obviously handheld. So if you're going to connect users with content and with services, you need to understand the context within which you're making that connection so you can optimize the user experience.

So let me give you another example of some underlying technology that actually supports multiple of these user experiences and that's dynamic transcoding. The problem here is that when you're using streaming media on mobile devices in particular, you've all had the experience of your video being choppy or cutting off and basically what's happening is you get handed off from network to network, you're going to have discontinuities in the viewing experience.

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Dynamic transcoding allows you to manage the user experience and manage the bandwidth dynamically so the solution recognizes on the fly what the network capabilities are, what the device capabilities are and then uses dynamic transcoding to match those two and it can change as the workload on the network changes. So this is sort of a unique approach in the industry. Most other players pre-process all their content which means they actually can't use dynamic transcoding type technology.

So this came out this year and we were experimenting with it. We did a test with our Telecom Italia mobile partners. They put it up live on their network to see how it would work. It worked so well that they just put it right into production. So we're in production. If you're in Italy and you're using their service you can watch soccer games or other live streaming video content on your cell phone. So a lot of work going on both in the fundamental technology and at the user experience level.

Let me switch gears now to the enterprise. This picture shows an image of a data center and it shows hot spots in the data center based on sensor technology that we've deployed throughout the data center. So as we move more and more into blades - blades storage, blade servers, bladed interconnect technology, the density of the data center architecture is continuing to increase and it'll be 10x over the next 10 years. That gives us a lot of power and cooling issues. And it's interesting because today the conversation we have with CIOs is really not around speeds and feeds as much as it is around how do I manage the power and cooling issues in my data center?

Power and cooling costs represent roughly 40% of the total cost of ownership in most data centers today. So this is a system solution because it's a systems level problem. You have to be able to managed power at the chip level, the board level, at the blade level, at the rack level and then at the data center level. And the key here is to remodel heat distribution throughout the data center and then using our virtualization and automation technology we can move workloads around, we can adjust the air flow in the air conditioning systems and do a number of things to really optimize the power and cooling levels in the data center so that we don't have to cool the entire data center to address one particular hot spot.

And this reduces our cooling costs by 25 to 50%. So it's a huge, huge improvement in the context of how we manage the next generation data centers. Now Randy's going to talk about this some. He's deploying a lot of the smart cooling technology in our own next generation data centers as he builds out the future data centers for HP.

The other dimension of this is the data center itself and how we manage the whole thing. So this is an overly simplistic view of a traditional IT stack. It starts at the infrastructure level with the blades and blade storage and servers and interconnect technology, operating systems, middleware, applications and business process.

Now these have traditionally been the important control and they are still important but we think there's a new really important control point as we wrap this data center -- this IT architecture in a set of services and HP management software that allows us to optimize the use of that IT technology and present it as a service or a managed service. So this is all about wrapping the data center stack in virtualization and automation technology that will deliver the whole stack as an IT service and today with our Mercury acquisition we can not only manage the IT stack, we can measure and monitor the performance of the applications through our test and development software and tools.

So two different dimensions. One is the infrastructure itself and the other is managing the entire data center, [presenting] it through service oriented architecture as a managed service. Ann is going to talk about this a lot. We think it's a huge opportunity for us and it touches on multiple of our TSG businesses.

So we spend about $3.6 billion a year on R&D. We feel really good about the level of investment that we have in our technology. We're not happy yet with the level of productivity so we're very focused on doing more and being more efficient with the spend we have there. But even at that level we can't do it all ourselves. So we're focused on M&A. Mark talked about it. Bob talked about it, but we're focused on it in a way that aligns with the growth strategies that we talked about earlier.

So in the printing and imaging space, our Snapfish acquisition last year - great acquisition that address consumer printing but it's also the infrastructure for a number of retail kiosks. And Scitex gives us a brand new printing technology at the high-end of

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the commercial printing space. Voodoo, one of our most recent acquisitions , this one's really cool. This is the company that has the leading interactive gaming PC. Very high-end system and I talked earlier about cooling in the data center. These PCs, you can see through them and they have tubes that run around and the high-end one is even water cooled. This is an example of us acquiring winners to fill out our roadmap.

Voodoo PC has won the ultimate gaming machine contest, which is a pretty intense contest, for the last four or five years in a row and for those of you who don't have your Christmas list finished, these are very cool. They've got laptops. You can get custom paint jobs. Custom graphics. I can guarantee you'll the only one out there with one of these because everything about it is fully customized. But the important thing is these are incredibly high performance systems and what we learn in the development rolls down into our high volume space and will continue to differentiate us in the market in our mainstream PC business.

Earlier last year, we added asset management capabilities to the Open View Suite with Peregrine and then this year you're all aware we really added a whole new set of capabilities to our management software with our Mercury acquisition which is completely complementary with what we're doing in Open View. It's sort of uniquely gives that wrapper that I talked about earlier in terms of being able to establish a whole new control point in owning and operating the data center. So a lot of this -- there's a number of things that we've done in addition to these targets, but this just gives you a feel for how we think about it in terms of aligning our M&A with our growth opportunities.

So in conclusion, there's a few things I want you to take away. First, HP is very technology rich. Our technology strategy is aligned to our growth strategy and we really are building all the technology that we need to establish HP as the world's leading information technology infrastructure company. But one of the more fun things we're doing is we're actually using it ourselves. So we're taking all of this technology, Randy and his team are building out the infrastructure for the future of HP. We are going to be the showcase for our customers and the world to demonstrate how you can use HP technology and how we will use HP technology to improve the performance of our own company.

So with that, I'm going to turn it over to Randy and he can talk to you about what they're doing.

Randy Mott - *Hewlett-Packard - EVP and CIO*

Good morning. I want to talk to you about a couple of things. One, as Shane said, talking about how we use the technology inside but I also want to set the stage a little bit with what's happening in terms of IT in large companies - large enterprise accounts and Ann will also talk about how our products and services deal with these accounts as well. But let me just give you maybe a perspective that may be a little different for you.

One is, with all of the discussion about technology. The change in price performance of technology and what's happening with technology, the fact of the matter is companies are still spending more, not less on technology as it relates to how our -- as you look at the global products in terms of domestic product growth around the world and that global world product, our IT trends are still scaling higher. Now, that might be a good news if those things were actually producing for our company but there's another challenge to that that we think we have a lot of things to do both internally, and I'll talk about what we're doing, but also in terms of how we help our customers.

The other side of that is there's a lot of people involved in driving this IT cost. Let me put it another way. Basically, instead of companies spending money on technology, you've got a couple of things on this chart. One is there are more people are involved in technology than ever before. Again, that might be a good news story if those people were doing innovation. The problem is they're maintaining old systems and legacy systems and old technologies as opposed to taking advantage of technologies that are available today. And even if you think about our markets -- the markets that we're here in the U.S. market today, the number of people in IT is higher than ever before.

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Again, not on innovation but on maintaining legacy technologies and the capital investment from companies is actually at a lower percentage than it's been a number of years. So again, not spending money on technology but actually spending money on people maintaining old technologies.

Now as that relates to us, let's talk about what we're doing. From an IT standpoint, I want to talk about what we're doing and then also talk a little bit about the application that that has to our customers and especially our enterprise customers. One is our mission, as Mark often describes it, is a simple mission in terms of four steps but it really consists of providing better information for our businesses.

We've talked about our portfolio and as we'll talk about it the rest of the morning about the breadth of our portfolio. We think that that's an advantage, but it's only an advantage if we have good information you can make good decisions to do that. So from an IT standpoint, we need to better enable better decisions, faster decisions about our business as we move forward and we make decisions around how do we best support our customers in those type of things.

At the same time, we have to reduce our costs but at the same time deliver significantly more and we think we can do both and I'll talk about some of our IT strategies here in just a second about how we get to that and how we do that. At the same time though, we need to lower the risk. We are a 90 billion plus company. We need to deliver capability services, products to our customers on a day in, day out basis and therefore we need to reduce the risk and make sure that the infrastructure we put together, the technologies that we provide for our business partners around the world is up and reliable and is able to then take care of our customers.

And then the last point is, as has been mentioned and Shane mentioned, is to be a showcase for our customers. Now showcase means to show how the technology that we use and how we deploy it is both cost effective and drives productivity and innovation for our customers, not just for HB IT. So let's talk about it in terms of five initiatives.

As we look at the environment that we have, it's really about doing a lot of things at the same time. Not unlike a lot of the transformation that's been happening in our company, the IT transformation is about doing a number of things all at the same time and we actually think that's the way actually to get this done and get it done in a timely manner is because they all complement each other. And I'll spend some time talking about each of them but there are five initiatives. They're all moving forward together and we're on a three year path to actually conclude a number of things that drive a transformation in terms of the technologies and the information we provide to our business partners.

So let's talk about it from the standpoint of just couple. One is portfolio management is around making sure that we're doing the most important things for the company. So we're still at the same time that we are certainly optimizing our costs, we're driving a number of initiatives across our different businesses, across our different supply chains, across our different go-to-market strategies. All of these things require systems and capabilities to better enable our people to do a better job taking care of our customers.

So at the same time that we are reducing the number, we're putting a much higher emphasis on making sure we do the most important things in working with our business partners and the executive council on making sure the projects that we do are the right ones. So we're putting emphasis on not having so many going on at one time, so we've reduced the number from 1,200 active to 500 active so that we're not spending all our time having ourselves spread too thin but actually getting projects done and if you want to think about it in terms of turning projects. So getting in projects. Finishing the projects. Delivering them to our business and then going on to the next project so that we're actually seeing the benefit of the technology or the application of technology quicker.

We're also at the same time trying to reduce the number of applications we have. We've got a very wide portfolio of applications. A lot of duplication that's happened for a lot of reasons as our business has evolved over the last number of years and really trying to get that down to the go forward applications, again reducing the number of the legacies reducing our time spent on maintaining applications and really focusing on new capability functions for our businesses.

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We've also spent a lot of time this past year and a half on focusing on return on investments. So as we evaluate our portfolio of projects work that we can do and which as with all of our organizations there's a long list of projects to do, but making sure that we have good financial background in terms of making sure we do the projects that have the best benefit, return on investment for the company.

If you think about workforce effectiveness, we've also spent the time as we have in the whole company at looking at where our people at. Where they're working. Looking at core locations. Making sure we've got the teams together and effective but also most importantly is really driving the mix. If you looked at the IT team less than half our people were working on innovation.

Most of them were working on supporting applications and we're really trying to change that mix and we're driving to a mix that we believe we can get with the changes in the transformation we're talking about, get to an 80% plus of the people working on innovation and less than 20% working on supporting or maintaining the existing environment and really optimizing what our people work on.

The other thing is we're transforming in terms of having more of our people that are HP employees. We think that's very important as it relates to business knowledge and how we align with our business partners in knowing our portfolio of products and services and being able to support that and our customers in the right way.

World class IT. Talks about a couple of things. I'll just hit a couple of them. One is a cost structure that really sets the benchmarks, not meets the benchmark but really leads the benchmark and we think that the transformation that we're undergoing will get us to that capability as we look at the upcoming couple of years. And then we've already talked about showcase.

I'll talk about two others that I'm going to hit in a little more detail. One is enterprise data warehouse and what we're doing there in terms of going from a number of data marks. Again, not unusual in terms of what a lot of companies deal with but really getting to an enterprise data warehouse so that we can get information globally around the world about our portfolio of products and make that easier for our business partners to both get access to as well as complete and timely so they can make decisions.

The other thing I'll talk about just a little bit is the data center consolidation, going from 85 data centers that support our internal business to six. Now this does not include all of the data centers we have as a company because we have a number of data centers around the world and we'll continue to have a number of data centers around the world to support our services businesses.

But this is the data center infrastructure that supports our internal business and really driving to [exchange] that next generation data center and so the data centers that are currently -- a couple of those or actually three of those are already up and running are employing basically the next generation data center kinds of concepts as well as our products and capabilities that have been developed across our product teams as well as across our HP labs.

If you looked at data center consolidation and I'm going to go pretty quickly through this but just to hit a couple of things. One is it really is a story of less and more, okay. Even though we're going from less applications we're certainly going to more global applications, more functionality, more features, more capability for our people that are in the field, people that are using these applications. So retiring a number of legacy systems and getting to the systems that provide the best capabilities for our people.

Going to 30% fewer servers but yet 80% more processing power. So if you want to think about it, it's just simply saying moving to the current technology. Moving to our best technology that's available in the marketplace today and doing that with fewer servers but at the same time a lot more processing power to take care of our business and our business partners.

A decrease in the cost of storage but at the same time we are actually going to double the amount of storage we have. We're going to fully replicate, which gets to the risk side, so from a business continuity, disaster recovery fully replicating all of our

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data so that again, we've got the ability to support our global business around the world much more effectively but even at a lower cost than the current implementation we've got today.

Half the cost of networking but at the same time over 30% more bandwidth. That really comes from a couple of things. One is reducing our footprint as it relates to our locations around the world but more importantly in consolidating the data centers, you've got less data going over the public networks being passed from data center to data center. So it's just a really a simplifying of the environment we've got and having more of that system to system communication happening within those data centers that are very tightly knit as it relates to our network.

And then the network typology you see there is really just saying that at the same time where we're going to fewer data centers and a more consolidated footprint, we will actually have better response time for our business partners because what we're designing in here in this next generation network as well is actually a two-hop system so from anywhere in the world, you'll only be two hops across a network to get to these data centers where the applications run and therefore provide the services.

So at the same time, 30% more bandwidth but if you look at the overall cost to run this network so again, more capability, more redundancy, more business continuity, but at the same time less cost to us as a company. Again, we think that's the same type of thing that we can deliver for our customers either in terms of helping them do that or providing it for them through our services business that we have.

Let me jump to just talk about how that fits in the framework and you'll hear Ann talk about a number of these. Shane already referenced a number of these components of our adaptive infrastructure but instead of having a current state where you continue to have more and more people involved in the supporting of an environment you really let the technology do the work for you.

So instead of having a number of people doing the monitoring, a number of people doing a number of the asset management kinds of tools right, whether it's the Peregrine acquisition we talked about, whether some of the Mercury tools, whether it's our own HP Open View, all of those tools really help to automate an environment especially if you implement them completely. The biggest challenge most IT organizations have is they implement parts of these tools but they rarely implement the whole portfolio and it's the whole portfolio that really leverages the technology and allows you to really optimize the environment.

If you - let me jump ahead to the other point I want to make a little bit is enterprise data warehouse. That's an interesting term that just really says having a centralized data model. So having a model of the information that's important to your company, the business drivers that you have as it relates to what decisions do individuals need to make at whatever place in the organization they are, having that information so that they can make the decisions in a timely manner that's responsive to both the customer as well as to the business needs.

We're certainly on a path to very quickly drive from a lot of information. There's no shortage of information but there is a shortage of consistent information across the company. So we're driving to fewer data marks, driving to an enterprise data warehouse and driving that across all elements of our business and we're doing it one subject matter at a time. So what you see on the chart is really a subject in terms of if you look at our product revenue data for example, shipment data, those things to very quickly have good information so as we think about go to market and a number of things that Mark talked about and Ann will also touch on in terms of is we try and make sure we've got people in the right places with the right customers, that we've got good information about those customers and what's happening there and really driving that to every part of our enterprise.

Now, one of the things you might say is that this has been around for a long time and what I would tell you is very few companies have actually implemented a full enterprise. They tend to do pieces of their organization that maybe happen to be high data concentrated that maybe they put a focus on but to really do an enterprise data warehouse, very few people do that and there's some reasons for that. We happen to think that we are actually addressing a number of those reasons.

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One of the reasons is cost and the technology to actually scale to that size. And so part of this again thinking about very much like next generation data centers in this case of enterprise data warehouse, we're actually using our own technology, a product that's the same Neoview which is basically in our case we've implemented 128 two-way servers, 182 terabytes of data. It's really driving, again ,a single image, if you will, of our data model and our data. Now we're actually implementing these in each of our zones, if you will. Each of the three zones of our data centers.

There's one actually being built out in Austin. There's already one in Houston that's running our enterprise data warehouse. But again, this is on HP technology. It's a combination of a number of parts of our technology certainly running on our platform as it relates to both the software as well as the hardware and it's on industry standard platform. So again, high volume makes it very affordable and takes away a number of the reasons that a number of companies haven't implemented this. So for us this is something that we need [for our] business back to that first charge of we need information.

We need information to drive the portfolio of products that we have to take care of our customers but it's an industry standard solution, certainly drives a price performance that is very different than what has been in the industry in the past. You're able to invest incrementally and every company needs one and that's a good thing. When you heard Mark talk about and Bob talk about revenue, it's good to have products that everybody needs and this is certainly one that fills that need.

Certainly drives our internal efficiency but it also drives the capability and us in position as a company to make decisions and again a highlight of really one of the things that we try to do which is working with our HP labs, working with our product groups with Scott's team over here and a number of the product teams that have been involved in that particular product, working with our services teams.

All of these things really we think gives us an advantage as it relates to not only having a portfolio of products that interconnect but also having on a very large scale the ability to go implement these things in a rapid timeframe that allows for really our business partners, our customers and especially in the case of our enterprise customers to have a place where they see that all of these things, how they're put together and what kinds of business results you can get as it relates to both efficiency as well as capability and those are the things we think is a fun thing to do from an IT organization and it's certainly a fun thing to do as it relates to working with our different teams across HP.

So with that, I think at this point invite Bob and Mark to come back up and kick off the first Q&A for our morning.

QUESTIONS AND ANSWERS

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

There probably aren't any questions I guess. I think we have a microphone that's roving around and make sure that -- because we've got --

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Andy Neff - *Bear Stearns - Analyst*

Mark. Andy Neff. How are you?

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

I know you're out there Andy, I can hear you, I can't see you. Oh hi Andy.

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Andy Neff - *Bear Stearns - Analyst*

And Bob. Just a question for you and for Randy just in terms of just following up on what he was talking about. Could you talk about benchmarking against the industry. Where do you think HP is in terms of IT in terms of the percent of sales? Where do you want to get to and I guess the second question is that how do your customers react when you say well we're going from 85 days to one and by the way we want you to buy lots of stuff. Aren't you telling them is there another theme that maybe you don't need a lot of IT equipment?

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

So listen, I think a couple of points. We haven't been giving the specific metrics as a percent of revenue. Percent of revenue, by the way, I find interesting data, I don't find it fascinating as a metric. We're more focused on percent of gross margin, cost per employee by function, those type things and I would just leave it to tell you that we've made some progress but we have a lot more to do in IT to get where we want to go. It's a multi-year plan for us. It's -- '06 was really the first year. We've got a lot of heavy lifting in '07 and '08 to get where we want to get to so big issues for us.

Secondly, the fact that we're going to market and doing internally what we're recommending to customers, Andy, is huge because frankly [I'll] explain to basically every CEO I run into exactly what we're doing and what our priorities are. Randy rattled them off. Basically every company wants to do what we're doing so it is a tremendous opportunity for us to shadow what we're doing in IT with our services capability and bring that to market as an offer.

So while there is virtualization that goes on in terms of our server count and things like that, we think everybody's going to go do this and the re-composition of that IT we think is a tremendous opportunity for us. Not just in terms of our position with the customer but our share of wallet with the customer because again Andy, it's important for us to be building to where the world is going as opposed to where it's been and we've laid this as new growth and it's a big opportunity for us. So no, we're pretty excited about the opportunity.

Bob Wayman - *Hewlett-Packard - EVP and CFO*

Keep in mind as well a big driver of our capital spending is the data center consolidation. So there's multiple years of increased spending so that too is an opportunity.

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

Bob makes a great point because I think - make sure - you look at the CapEx numbers that Bob showed you earlier and our increase in '06, we basically have forecasted similar CapEx to what we thought we'd spend in '06 basically in '07 and we are spending CapEx to basically put ourselves in a better long run cost position. So in many ways it's a driver of capital spending and we think everybody's got to do it sooner or later especially when you look at the labor rates that Randy is showing to you. Too much of IT is showing up in labor. Not as much of it is in the refresh of the infrastructure, which is what we think drives long term health.

Ben Reitzes - *UBS - Analyst*

Good morning, Mark. Ben Reitzes, UBS, and Bob. I wanted to ask about your view on all your restructurings so we could just kind of pin it down. Is it -- initially with the 15,000 headcounts you guys talked about $0.30 flowing to the bottom line and then later you had an announcement come out about a billion in data center savings and I was wondering if that was still the right number by I guess next year and then also if you could talk about your real estate savings and kind of just frame those three initiatives into maybe the exact bottom line savings. Just well some kind of number for us.

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

So Ben, I think it's very nice of you to ask it that way but we're not doing that. So at the end of the day we're not forecasting at that level of specificity. I think your numbers are right about the restructuring so that's exactly what we described that roughly half of it would show up in the bottom line. Half of it would in some way shape for form be reinvested back into the market or back into additional resource, additional sales resource being the one example of that.

We have work to do in IT and real estate. We haven't given a discrete number. I know there's a lot of guesswork that goes on out there but I'm not going to pigeonhole us to a specific destination or to a specific timeframe other than to tell you we've got a lot of opportunity to go get it right and we're going to go do it.

Ben Reitzes - *UBS - Analyst*

A quick follow-up is you're in the mid-20s. Some of your competitors are in the mid-40s. You know we've talked a lot about operating margins but given your views on the gross margin line is there anything -- do you think the mid-20s is a good number or do you see that going higher or when you talk about costs is it mainly overhead?

Bob Wayman - *Hewlett-Packard - EVP and CFO*

Our mix of business is very different than any one competitor that you point out. Clearly, we have a huge range of gross margins from the teens in some businesses to 80s and 90s in other businesses. So it's very hard to talk the competitive compare. Mark, I think, laid out the fact that we view the cost of goods and cost of services as part of the overall cost equation and we're going to work to drive that down and our gross margin up. At the same time, pricing is one way to capture market share and so there's a constant pressure on gross margins going down because we want to win more business. How those two net out, we'll just have to see.

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

I think the mix is important. So for us you saw what happens when we gave our forecast on gross margin of the Mercury impact on overall HP's gross margin and that's with several hundred million of software revenue. So mix is critical. As I said earlier, if we grow faster in PSG than the rate of the company that will have an effect on gross margins. If we grow faster in software than the rest of the company will have positive effect on gross margins. So I think it's that mix.

Cost and services is everything. So at the end of the day, that's -- all of our costs not all but the majority of our costs and services is above the gross margin line, not below. So for us again we're trying to get rid of costs and our big strategy there is frankly not to just arbitrage [labor] but actually to automate it and eliminate it. So we'll see where we go.

Shannon Cross - *Cross Research - Analyst*

Shannon Cross. Cross Research. Just a question -- actually I have two questions. One with regard to sort of contra revenue and your net revenue line because I would assume many of the costs sort of netted out in revenue are very high margins. So we talk about the $84 billion in cost cutting but anything you can provide us with specifics on that and then I have a follow-up.

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

First of all, I think Todd's going to, Shannon, come see you at the break because that notebook you've got is a challenge to be staring at from here. On contra, Bob you want to take contra first? But I mean it's a big category for us but it's a mix of things

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for us. I mean contra has discounts -- standard discounts. It's got market development funds, demand generation funds so it's a broad category so I'm gun shy to generalize about it.

Clearly, we need to make sure our contra is aligned to our channel strategy so it's a big deal for us to make sure that the money we spend in the channel is aligned -- not just that it's right, but that it's compensation just like we'd be compensating our own people and that's some of what you hear in the channel in terms of feedback both positive and negative.

We are rewarding behavior with some of our channel compensation and I think you should expect more of that. We are going to be a little different in the ways that we compensate, that the more tax you drive, the more you help HP the better that channel compensation will be and we're going to continue on that. And we will continue to comb through every dime of contra just like we would anywhere else to ensure that we've got it right.

Shannon Cross - *Cross Research - Analyst*

Just to clarify. Our notebooks are more based upon the operating system that they use and the virus potential than the hardware that's there but the second question I had which is with regard to the ability to leverage across all the business units. You know we talked to people in IPG. They don't necessarily talk to the services side that much. I'm curious as to when you look at your revenue growth opportunities how much you think more interaction within the business units is key to achieving the 4 to 6%?

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

Well, listen. We have models that depend on levels of collaboration Shannon. So I mean it can't be -- for example in the enterprise print example I gave to you earlier, that does require assets from both PSG, specifically HP services, at the same time as it does IPG. I could argue that enterprise servers and storage brings assets to the enterprise print opportunity as well.

So we need to have collaboration and I would argue to you if we leverage that collaboration appropriately and those resources appropriately we have a value proposition unlike anybody on the planet to be able to execute that solution set. So yes, we need that collaboration. I want to make sure I'm more clear. I expect that collaboration.

Harry Blount - *Lehman Brothers - Analyst*

Hi, Mark. Hi, Bob. Congratulations on your ultimate retirement here. Harry Blount from Lehman Brothers. One clarification and then some broad questions. On the revenue guidance for FY '08 preliminary is that assuming some of those targeted acquisitions or is that just strictly organic?

Bob Wayman - *Hewlett-Packard - EVP and CFO*

That is assuming a modest acquisition spend. More like what you saw in '04 through '06 roughly $1 billion a year. So it's the smallest acquisitions that we've typically done and we can only generally put into the model without any specific target in mind..

Harry Blount - *Lehman Brothers - Analyst*

Mark, as it relates to the strategic view, as I look at the guidance here and I look at the size of your IT hardware on the enterprise side, you're almost comparable to IBM in terms of size but if you look at the software and services attached to that hardware you're much smaller and the growth rate you guys are projecting of 10 to 15% on the software side still doesn't get you anywhere close. Do you view them as having the right relative mix of software and services ultimately?

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

You, them being defined as IBM?

Harry Blount - *Lehman Brothers - Analyst*

The relative mix of hardware/software --?

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

I think Harry you've got different comparisons depending on categories so I think when you say the word software you get into a very broad term. The company you mention has a database. They've got a mainfame business that drives a tremendous software attached that rallies around that mainframe ecosystem. We don't have a mainframe ecosystem to leverage around so for us we're really focused on building out the management category. You're going to hear Ann talk about that in a little while. We see the space of enterprise management whether it's systems management, network management, security storage management as a category.

We believe that category will emerge just like any RP category or database category and the more important thing for us is that we want to lead that category and where that category takes us will be where our sales go. So I think you should expect us to look organically in Randy's mapping about what it takes to go build out this data center strategy, we're mapping modules of software down to the module level to make sure we have that offering complete because we have to have it to be able to execute our strategy.

So we think more that way than we do a financial analysis of this guy's got this much software and we have this much so we better go cobble together some acquisitions that don't fit together just to get a software number. So it will be all for us about strategically building out that category.

Harry Blount - *Lehman Brothers - Analyst*

Great. And then the last question is on the consumer side. Consumer is are going to grow arguably 2 to 3x what the enterprise is yet it's almost the same opportunity. You guys are a huge player in consumer but I still haven't really heard you guys enunciate a real strong and clear strategy on that beyond [more or less] the PC group. What should we expect there?

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

I think, Harry, it's probably really better to wait until Todd and VJ get up and talk about where we're headed on the consumer space because I think you'll hear a lot of talk about the consumer in the context of both. Harry, the core. So there's a core part of our consumer business, which I think is your point. There also are adjacencies that we think are pretty exciting too and so I think you'll hear both talked about when we get past the break.

Frank Timmons - *Baird - Analyst*

Yes, hi. Frank Timmons from Baird. You talk a lot about you're transforming your business. You've taking layers of management. I was kind of curious on leadership/change management. You still have a lot of the [full rank] employees working hard that have been there a long time. I know you're maybe changing the incentive structure et cetera but how do you keep people motivated? You're clearly pushing on people harder these days. We see stock comp coming down. Give me your thoughts on how you can keep people engaged and continue to push them to work harder and get more out of them?

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

Well listen. I mean the number one formula for people being engaged is winning. We can come up with all kinds of different incentives plans and so forth. When people feel like they're part of a winner, people get excited about their work. When they feel like they're making a valuable contribution to helping change a market, helping change a company, people want to participate and we've shown up -- our remuneration is not only stock it's also bonus.

You've seen Bob talk about some of our bonuses as well and we've gone a period of time where we've seen our stock price incline. We've seen our bonuses incline. We've seen the perception of the company's strategy and operations improve and so I think -- our employees, I think, are highly engaged. We survey our employees quite a bit. I think they're pretty excited about where the company's headed.

Don't let me confuse you though. We've been through and are still going through heavy lifting. So you can find inside Hewlett-Packard today almost anything you want to find. You can find highly motivated, highly engaged employees and you can find those that say hey, we still have -- because I give the same message internally that we do externally. We are not transformed. We are transforming. So we still have work to do and so you've got all of that together but I give you my observations as I said in the earlier chart, I think, first of all, I am really proud of HP employees. I think they have done an incredible job and they have all of my thanks.

Secondly, we have more work to go do. I'm optimistic we're up there.

Bob Wayman - *Hewlett-Packard - EVP and CFO*

If I could just add, I think another key motivator for employees is opportunity and when you do add 5 billion in revenue growth like we did this past year that translates into growth not only in the financial sense but there is more to do within the company. There's new job opportunities and we are focusing more heavily these days on more clearly showing employees how to capitalize on those kind of opportunities through career development tools and training and those sorts of things. That matters as well.

Frank Timmons - *Baird - Analyst*

Thanks.

Tony Sacconaghi - *Sanford Bernstein - Analyst*

I guess good morning. It's Tony Sacconaghi from Sanford Bernstein.

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

Hi, Tony.

Tony Sacconaghi - *Sanford Bernstein - Analyst*

I have two questions, please. The first one is about the trillion dollar addressable market that you mentioned upfront, Mark. What do you think is really the market growth rate? You had said that HP is going to grow at 4 to 6 and I think you had talked about share gain. The implication is that your addressable market is growing less than 4, which is lower than nominal GDP, so can you reconcile that?

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And then secondly, on the EPS guidance that you've given for '07 and '08, you actually have an acceleration in '08. The midpoint of your guidance is for 13% EPS growth in '07. It's 15% in '08 despite the fact that you have a higher tax rate. So you can you reconcile why that is? Are some of your cost savings more backend loaded towards '08 or ultimately is there some other consideration about your confidence level about the broader economy?

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

Let's start with the EPS. I can go back into the TAM

Bob Wayman - *Hewlett-Packard - EVP and CFO*

Yes, but there are some cost savings that are backend loaded. Specifically take IT. '07 is a year of investment. There's still some net cost savings in '07 but it's a heavy investment year and you'll see greater savings out in the future. Real estate as well. Very long lead time on transforming from where you are. Consolidating sometimes entails building or finding new buildings. It takes time. So yes some of it is logically related to the rate of cost savings..

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

And Tony, I think, to Bob's point, it's probably the best evidence that we can give you that we've just got more to get done from a cost perspective. So it does show up in the numbers and the guidance that we're giving you.

On the TAM, I've could go on for a long time about -- because the total addressable changes to your point by enterprise to consumer to SMB to Harry's point. You have a different total addressable market in consumer versus enterprise. Simultaneously, you have very different total addressable market growths in emerging markets versus mature markets so when we get out to a China and we get to Russia and when we get to India, we're seeing 8% GDP growth on an average of those three, IT growth rates in the 11, 12, 13% and opportunities to grow much faster than even the IT growth rate because of the newness of infrastructure being laid in those marketplaces.

So the total addressable market when you look at our weighted average of categories that we participate in is probably -- let me put it this way, it's within the range of the market growth that we're giving you. But there are opportunities if we're going to participate on the higher end of those ranges for us to do a little better than that in terms of the share position. So I would not call it a huge stretch but we'd like to gain share, Tony.

Bob Wayman - *Hewlett-Packard - EVP and CFO*

Tony, the other point I should have mentioned is Mercury. Mercury definitely hits '07 and then it becomes beneficial in '08.

Tony Sacconaghi - *Sanford Bernstein - Analyst*

Sorry, Mark but if I could just follow. Mark, it's Tony. But I'm just curious about your perception of IT spend because again, if your targets really are 4 to 6 and I appreciate the distinctions across markets but if your target and that's a large part of the total IT market, I think Gartner would say it's 1.4 trillion. Your TAM is 1 trillion. But the implied perspective on the market is that the market is actually growing in low single digits if your other statements do in fact hold. Is that really your belief on a go forward basis and again --?

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

Aggregated together. Aggregated together, yes. That would be my view. Now again, the reason I hesitate, Tony, is because it's a very different story -- there's so many stories within the story that I'm gun shy to give you such a generic view of the world. That's why I hate to dive down in details but that's where it is. It's into the details of it. So for us, by geography, by sub-segment, by enterprise, SMB and consumer, these are just very different stories. So you've got consumer with a strong growth rate relative to what you may see in some of the enterprise but yet there are different share opportunities for us depending on what segment you're in at the same time.

So again, I think the bigger opportunity for us is we don't want to think about it just in the context of here's the market growth rate so therefore our destiny is the market growth rate. We have to go into a fair more level of analytics than that to be able to determine what our growth rate is because we've got positions that markets with no growth where we have opportunities to have tremendous scale in our growth rate or in our growth of our business. Sorry, I can't give you a more specific answer but I mean there's just a lot more detail to it than that.

Laura Conigliaro - *Goldman Sachs - Analyst*

Laura Conigliaro, Goldman Sachs. You mentioned that if you execute you could become more aggressive. When could we start to see a more aggressive Hewlett-Packard and what would be the potential product areas that you'd be targeting first?

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

I have no idea where you are, Laura. Oh there, good. It's hard, I can't see. I don't think there'd be a click-on day, Laura. I don't think you should -- I'm hoping that in my belief, in '06 you saw more aggressive HP. Specifically, as you got to the back half of the year and you saw our unit growth in IPG. You saw our unit growth in PSG. Frankly, we did a lot of work in the year to be able to not only improve our costs but also to improve the variable fixed nature of our costs so that when we saw growth opportunities we could take advantage of them provided they gave us profitable growth.

We'll continue to align that model so that we can try to get more and more market facing flexibility as we go forward but I don't think, Laura, it's going to be a day when you say, yes this is new, more aggressive HP. I think it will be a process that will unfold over the next period of quarter and you're -- you have to have a microphone probably to be able to do that if you've got one. Tony, down here asked three questions out of his.

Laura Conigliaro - *Goldman Sachs - Analyst*

Thank you. Okay, well, I have a microphone back. You had actually said early in '06 that you were going to be more aggressive or that it is likely that you'd be more aggressive in the printer space and maybe there was a bit of that in '06 but not as much as it would have appeared considering how early on you mentioned it versus when we actually saw it. So is it logical for us to presume that '07 is really the year of more of that and then are there other areas that would be more aggressive beyond that?

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

I'll let you ask VJ about how aggressive we're going to get in '07 in the printer space but I tell you that when you close the back half of the year in mid teens and low teens unit growth in printers and particularly, when you look at the high use of segments, we think we are pretty aggressive.

We think we are pretty aggressive in a thoughtful way to go after high use of segments that bring us reasonable after-market opportunities and I do think in the back half of the year we saw the opportunity. We tried to align our cost structure to take advantage of it and I think that IPG did a nice job executing it as I think you saw that in PSG as well.

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Bob Wayman - *Hewlett-Packard - EVP and CFO*

Well take one more question.

Keith Bachman - *Banc of America Securities - Analyst*

Hi. Keith Bachman, B of A.

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

Hi, Keith.

Keith Bachman - *Banc of America Securities - Analyst*

Good morning. I have two questions if I could. Mark, you've talked a lot about even over the last quarter about increased enterprise penetration through sales force hiring and things along those lines. Cisco's done a bit of that. Can you tell us where you are in that journey and how we should see that unfolding? Is it in '07 revenue acceleration? Is it '08? Can you just give us a little description and I have a follow-up, please?

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

We've done a fair amount of work. We've tried to start -- because when you build a sales force there's a market segmentation dimension and we had to go do the work that said if we're under, where are we under because that's eventually got to translate to a specific territory or an account that you apply resource to. So we've been able to do that work. Although that work is done and we're continuing to refine it.

Secondly, you then have to be able to get the right quantity of resource to be apply against that opportunity and it's again for us to create more demand for HP not indirect or direct but just get more demand for HP. Thirdly, once you hire that resource you have to train that resource. You have to prepare that resource, arm that resource, tool it and then be able to follow-up with a continual process of creating royalty and dealing with share wallet and starting to approach customers and deal with our opportunities.

We have gone through the segmentation phase. I'm pleased that we've made progress in that segmentation. We're actually now keeping data about our sales force which is good. So we actually have history or we have now a little bit of history. We're going to have more. Then we're beginning to train and we frankly built our models up not expecting a lot to come out of the first groups of hires in the short term because frankly it takes time.

Many of these accounts, Keith, we haven't called on them in a long time and we show up and say hi, we're from HP and they say -- not many of them say gosh, we've been waiting for you guys. Here's a whole bunch of orders. Most of them want to know what we're doing. They want to understand our strategy. We have to apply our resource against their issues and their problems. So it's going to take us time to get that built and we haven't built a lot in the short term but we would hope that would mature over time and drive some more growth for us over the long run.

Keith Bachman - *Banc of America Securities - Analyst*

Is there any metric on how many sales reps you're going to be hiring? Any kind of metrics you can give us associated with it so we can --?

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

Sure. There are lots of them, I could, but I won't. So we're out trying to drive. We have hired. I'll use this term, I think we did it on the call. We have hired hundreds of people. That's the only metric I'll give you. And we are tracking but I will tell you, rest assured if you're a shareholder, we track by person not just what they sold but they have in their funnel. So we're looking at the speed by which the funnel ramps. We're looking at gross margin per funnel and trying to understand the way that we basically start to breakeven getting incremental performance as we go further with our investments.

Keith Bachman - *Banc of America Securities - Analyst*

Bob, my second question if I could. Just operating cash flow looks like it's down a little bit next year versus this past year. Wasn't sure why that would be the case.

Bob Wayman - *Hewlett-Packard - EVP and CFO*

Working capital improvements in '06 were stronger than what are sustainable on a going forward basis. Cash bonus payout is substantially greater in '07 than '06.

And at this time, we will take the break. We're going to get started right at 10:15, so move in and out as quickly as you can.

[BREAK AND RESUMPTION OF EVENT]

Ann Livermore Good morning. Over the next half-hour, I'm going to give you an update on the business results for the technology solution suite for FY '06, then also share with you some of our plans for '07 and beyond.

But before I jump in, let me introduce a few of the executives from my team who are here, because some of you may be interested in speaking with them during the Q&A over lunch. First, we have Scott Stallard , and Scott is the executive who leads our server and storage business. Many of you know Scott and have met him in the past. John McCain, who is leading HP Services, and he is just in this job about a month or so and eager to be able to talk with you. Jim Murrin, who leads the Finance Organization for all of my group, and then finally, we also have [Mark Levine] from the Services Organization who leads the finance team. So they'll be available during lunch.

PSG represents three of the reported segments for HP; the Server and Storage business, the Services business and also the Software business. Together, they represent about 37% of HP's revenue. Last year, $34.2 billion in revenue. It was up 3% in dollars, 4% in constant currency. At the same time, we delivered operating profit of 8.9%. That was up 3.2 points year-over-year. So there is substantial improvement in the operating margin. On a relative basis, while revenues grew 3%, operating profit grew 60%.

We were pleased with the progress across all the businesses. We saw margin improvements across all three business segments, and also across all the geographies. Now we're working on continuing to work on the cost structure to drive more improvements there, but also to layer more growth on to of this improved business model.

The operating framework aligns directly with what Mark showed you earlier for HP. We very much have our cost work, our efficiency work linked to our growth activities. We want to be able to use the lower cost to price to win and at the same time deliver a good value for our shareholders, and also to be able to invest in additional sales resources. You've also heard already some comments about our capital strategy, how that fits with our business.

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Our goal is very specific and you can see it stated in the middle of the triangle. We want to be the best at helping customers manage and transform their IT environment, very much the same sorts of things Randy was talking about. We care about manage, because that's 65% of the spending of a CIA, a huge pool of their dollars, and transform so that HP's the company that takes them to the next generation of computing.

When you look at the market opportunity for our set of businesses, it's very large. You can see each segment and these line up with the portfolio we have inside of PSG. By '09, a $470 billion market, the weighted average for us of the growth rates across those markets 4.5%. Within segment, different growth rates. So different growth rates for the server market, for example, than the software, and even within the categories very different growth rates. So within servers, you may have a declining mainframe market at the same time that you have a very fast-growing blades market. Similarly, about the segments within storage and within the services subcategory.

So a nice market growth opportunity for us, and on top of that, you heard Mark talk about share of wallet. If we look at the global 2000 collectively, we have a single-digit share of wallets. So we also have a big opportunity through our improved sales coverage and activities to capture a larger share of wallet as well as to enjoy the growth rates happening in the marketplace.

Sales effectiveness, you heard Mark talk quite a bit about this. We have a lot of the work underway associated with these actions inside my set of businesses. When we look first at sales coverage, we know that we did not have a dense enough coverage, enough dedicated resources to our largest accounts. We've hired hundreds of sales reps over the second half and through the first half of this year and are applying them to our largest customers, where we believe that a denser coverage will allow us more sales opportunity.

We also have a very large channel network, which is very important to our growth activities and our ability to meet the small and medium-sized markets, as well as our enterprise customers. You'll see us go really hard at the mid-market with our channel partners and pushing very aggressively blade, x86, storage and the support attached with it.

Our ISV partners and our systems integration partners are key to us in terms of generating sales. We have the strongest position in terms of server units with SAP, with Oracle and with Microsoft. We intend to keep and do everything we can to extend that with those key partners, and also with the big systems integrators.

Finally, you heard a lot of comments from Mark about the discipline we're putting behind our sales activities -- the planning, the analytics. We're also doing more and more to look at not just the revenue impact, but also the margin growth associated with our sales activities, tying investments in sales back to margin generated by the sales and also being able to tie compensation, not just to revenue growth, but also to margins.

What matters most to CIOs? These are the problems that we're attacking, and we believe we have great products, services and bundled solutions to be able to address these problems. The list should look familiar with you. We're trying to solve the same problems that Randy is pushing for HP, and while Randy has being a showcase as one of his objectives, it's my sales team's goal to have enterprise customers being all being showcases of HP's technology.

You can see at the core or each of the components we have to be a world leader in our servers, our storage, our software, our services individually, and then we bundle them together into a set of solutions. First, the adaptive infrastructure, our solution taking customers to the next generation data center, our leadership around enterprise management, both with our software as well as our services, and this we're bringing to market in a value proposition we call business technology optimization, and finally, information management.

Here is the picture for the adaptive infrastructure. You saw this last year at this meeting. You saw it earlier from Randy, taking today isolated pools of IT assets that are very underutilized, driving higher utilization, higher automation, less labor required to operate the IT infrastructure. You can see the key enablers, and these are the areas where you'll see us invest our R&D dollars for a leadership position for HP, software investments around management, around virtualization, around automation. Leading

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products in terms of the servers and the storage, and Shane talked quite a bit about how we have a very differentiated capability in power and cooling. You'll see us focus our services activities, our software activities and our product activities around these areas for leadership in those categories.

Business technology optimization, this is the branding that Mercury used and we have adopted inside HP to use as well. It has at its core the Enterprise Management software and services capabilities that we have in our portfolio. You can look at this as the ability to take the things that IT does as a function as well as strategic IT initiatives and linking them very specifically back to business outcomes. HP Openview, you remember, as being very focused around managing servers, storage, network, applications.

Also, in terms of automating key IT processes and enabling IT service management-type activities. We add to that with Mercury incredible depth around the applications, the development, the tests, the deployment, the management of applications, also strength around [solo] and the management of service-oriented architectures, IT governance software, and also software around program and project management for IT. So we fill out this entire portfolio and have a set of capabilities in our software organization. Our services lined up around it to deliver great solutions to our customers.

How does this look compared to the competition? You can see the list of categories in terms of the key functionality in the software category, the business technology optimization category, listed down the side. The green represents where each company has either a number one or a number two position, and you can see that the combination of HP software with Mercury software puts us number one in six categories, number two in two categories. So no doubt, the clear leadership position in terms of functionality for this key software category.

And with the combination of HP and Mercury, we have a nice sized portfolio in terms of our software business, over $2 billion, and you saw Bob's guidance earlier for '08 in terms of revenue growth between 10 and 15% and operating profits between 18 and 22%.

Our services business. Our services business is absolutely key to the value proposition we deliver to our customers. When we talk about manage and transform a customer's IT environment to deliver better business outcomes, our services organization is perfectly aligned to that mission.

Our core offerings are around the optimization of the IT infrastructure, and along with that comes all of the work around [DTA] and management, the modernization of applications and the work that we can do around service-oriented architectures, and also information management. So you can see how our services business is growing as a services business, but also adding value to the overall solutions and the portfolio strength that we have within CSG.

Different elements of the portfolio, our technology services, a slow growth market about 50% of our overall revenue stream but very important to us because of the profit generation and also the customer satisfaction that we drive here. So this business has incredible impact on the loyalty and satisfaction of HP's customers to buy everything else in our portfolio. Our consulting and integration business, we're very focused on a targeted set of accounts as well as a targeted set of solution areas, and again, this is important to the relationship we have and the positioning for HP's overall set of solutions.

Our managed services business, this is the fastest growing segment of the services industry, important to us for the services revenue it generates, but also the position it gives us with our customers and the ability to pull through the whole rest of the portfolio. You've heard us many times over the last year talk about the fact that we are focused on the cost structure and the profit improvement of the business. We are very pleased with the progress that we made over the last year, and you've seen that in the results of the business.

We've got a lot more work to do. You'll see us continue to push on those activities, but at the same time focus on growth so that we can bring more revenue through this new, improved business model, and we'll focus, as Bob mentioned, both on organic growth as well as some potential M&A activities in this space.

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We talked about information management as one of the solution areas, and we're highlighting this associated with our services business. Also, key offerings, and a key part of our solution we bring to market has to do with the servers, the storage, the software and also the services. So it's a great portfolio [play for]. There's a very significant market opportunity across all parts of this portfolio, very significant around the services component of it. We're involved around the whole lifecycle of the information in terms of being able to capture the information, being able to manage the information, being able to retain it and then being able to deliver it to the customer.

If you look today, we have intellectual property, both in our services business, as well as in the software, and you heard Randy talk through the capabilities we have with HP Neoview. We're taking that to market and offering that as a commercial offering as well as using it inside HP. We have a tremendous relationship with both Oracle and with Microsoft, and do in a year 250,000 implementations of business intelligence, and we have thousands of customer facing resources.

Just this morning, some of you may have seen the announcement we made with our intention to acquire Knightsbridge Solutions Holding Corporation. It's a professional services firm. They have 700 employees who work in the United States and in London. They are viewed as one of the leading services organizations around business intelligence, enterprise data warehouse solutions, around data integration and also around data and information quality. The company's been in existence for 12 years. They're focused on the Fortune 500 accounts. They give us an incredible strengthening of our services capability and our sales capability to take these solutions to the marketplace. So we're excited about that and expect the transaction to close within 30 days.

HP Services, operational effectiveness, I told you we still have lots of work to do around the cost structure and improving our operational effectiveness. As Mark was talking earlier about the target opportunities to reduce costs, if you take for services revenue last year, subtract operating profit, we've got about a $14 billion cost opportunity to attack here. You can see the four levers that we believe are the biggest levers that we can pull associated with this.

Our data centers that we use to deliver our outsourcing contracts to our customers. Some of these are customer-specific centers, some are global centers, some are regional centers. You'll see us doing in those centers the use for our customers very similar things that Randy discussed in his data center consolidation and the modernization of the technology. We'll deploy HP software to automate everything our services people do so we need less labor to deliver those services, to set up activities and initiatives there very specific to the data center costs.

On the other end of the spectrum, you see the call centers. We're going to leverage the call center infrastructures that Randy has. We're optimizing that infrastructure, also working on the call handling processes inside of it. Two other categories that are more labor focused: One, just purely the labor across all of HP services. Over this last year, we have, by the end of '06, the fiscal year we just closed, 32% of our services employees located in nine global delivery centers around the world.

We also are reviewing compensation, the productivity metrics, every single aspect of making sure that our labor costs are the most competitive in the industry, and that's what we're striving for there. We also have a huge opportunity around the delivery of support services. You know that our technology services business is quite large. We can use technology and automation to do things remotely. We can also make that work for us more productive, and we're going hard after that category. Also, around the materials with spare parts management.

Underlying all of this is a set of work we're doing on making our processes more global, only inventing tools and processes once centrally and deploying them and using them all over the world. We think when you -- when you think about labor arbitrage, that was the work most companies needed to have done over the last five years. The next five years from the services business is all going to be about automation of services delivery, and we believe that with the help of HP Labs and our R&D organization, we have a great opportunity to lead here.

Now looking at the server and storage business, many of you have questioned that as the portfolio shifts more and more to an x86-type environment, what's that going to do for our gross margins? You can see that in FY '02, we had 61% of our server

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revenue in the x86 space. 39% of it was [risk]. The fiscal year that just closed, the combination of blades and x86, 73% of that revenue, Integrity 10% of it and the risk based part of our portfolio only 17%.

So a lot of this transaction, transformation, transition in the cost structure, the nature of our portfolio mix for servers -- a lot of it's happened, and we have adjusted the cost structure, the margin to be able to compete in this kind of environment, and I think you saw that in FY '06 in terms of the margin improvements and the financial performance of our service storage business.

If you look at our product position in terms of market share and growth, we've out-shipped all the other companies in the industry standard server space for over 10 years. So we have the number one position there. We also have a number one position if you look at operating environments in all the forward-going operating environments. We don't care about the mainframe operating environment, but we care about the forward going ones, and we have the number one share position in all those categories. If you look at Integrity, it grew nicely over the last year and has now become a significant part of our portfolio.

And then finally, we're very excited about blade, as you heard Shane mention, and think we're very uniquely positioned for this marketplace. What is blade all about? HP's strategy is to blade everything, and it's great for us because a blade is exactly what we sell in our portfolio, and we have the opportunity to capture all of the components of the results. What's included inside of the blade?

The server blade, the storage, the network components, the management software, the virtualization software and the differentiation we have around power and cooling. From a customer perspective, there are no question that blade is a great thing. If you look at the facility cost, if you look at the cost of acquisition and particularly the administrative cost, dramatically lower for a bladed environment. So there's no question that this is the way the world's going.

Our leadership in the industry standard components -- the fact that we ship a server every 12 seconds positions us very strongly for blade. We've got the component aspects, and we've got the cost structure and the business model to lead in the aspects that require a volume business model, low cost, high throughput, and at the same time be able to do a value sale in the high-value services around it. So HP is very uniquely positioned for this marketplace, it plays to our hand.

If we look at storage, this is an area of the business where we've made a lot of progress, but we still have a whole lot of work to do. We know we can do better in storage in terms of our market position associated with it. Over the last year, we made tremendous improvements around the margin associated with the storage business. So we focused on our improvements there. We have more work to do around growth.

You can see that the market opportunities vary quite a bit by segment. If you look at NAS, you look at software, you look at SAN. All of those segments of the storage market growing in double digits. So attractive growth. If you look at tape, and tape is declining about 4%. We have about a third of our portfolio that's tape. So it's part of what you see in our growth challenge is a big position in one of the slower growth segments, but it's a very profitable segment, it's an attractive segment. We like being in that business. But it does dampen our overall growth in the storage segment.

We have a strong position around our mid-range array with the EVA and with our [pleased] associated with that. We have a relatively small position around software. We have our AP IQ software for storage resource management. We also have our position with OuterBay for optimizing archiving. You've seen us talk as well about our work around ILM. We have a software position there, but overall a small position in both NAS and software, which are two of the faster growing segments.

You'll see us continuing to work on improving our go to market. We still have work to do there and aren't yet satisfied with our [gross] set of market associated with storage, and we're investing both in dedicated resources for our large customers as well as our mid-market program. We know that the channels in the mid-market is a strength for HP, and so one of the areas we're focused on for storage is how do we sell into small and medium business.

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Some of you may have seen the introduction we made back in September around our all-in-one offerings as targeted specifically for that marketplace. So there's still a lot of work to do in storage. We've made progress, not yet satisfied with our performance in this segment. It will be an area of focus for us as we move forward.

If you put together all the categories that I've talked through so far, this is a summary of the things we're working on to go after growth. First of all, just increasing the share of wallets in the largest customers, the Global 2000. We'll do that both with our direct selling as well as with our partners. You'll also see us attack the mid-market because we know we have more opportunity there.

The categories of services and products listed on these slides are the segments that are growing the fastest. So we're putting extra focus and attention around the high-growth segments. We're building out some capability from our go-to-market industry expertise because we know our customers want that from us, and we're also very focus on attach, attaching services to every product we sell, and when we leave the services, pulling the whole HP portfolio along with our services position, and we believe that this is a set of activities under our control, things we can go after, all good growth opportunities for us.

So to summarize the position overall for the Technology Solutions group, you'll see us focus on growth. We've talked a lot about that. We believe our portfolio is very well positioned for the parts of the market that have the best growth opportunity. We also know we have a big opportunity around share of wallet and improving our sales effectiveness. We'll work on all those things associated with growth.

You'll also see us continue to be very rigorous around our cost management activities and going after every aspect that's there in terms of setting the benchmark for what it means to be cost competitive in these marketplaces, and we'll keep a very, very strong focus around leading the industry in customer satisfaction and loyalty, and as Mark said during his presentation, we know that this is one of the things that drives more growth and one of the things that's key to HP's ability to have a sustained differentiation in the eyes of our customers.

That's it in terms of the update. We'll look forward to your questions, both during lunch and later on, and now what I'd like to do is to turn the floor over to Todd Bradley. Thank you.

Todd Bradley - *Hewlett-Packard - EVP, Personal Systems Group*

Thanks, Ann, and good morning, everyone. Before I get started, just a couple of things. Shannon, I got your business card. Thank you very much. We'll be calling this afternoon, hopefully to convince you of the error of your ways. But needless to say, still more units to sell. So look, I'm going to spend some time with you this morning, about 20 minutes, take you through a little bit of our history, but more importantly talk about how we've positioned ourselves and how we're driving profitable growth in PSG. And like every good story, we've had an awesome year, and you never want that to end. But clearly, as we look to the future and look at the foundation we've created, I think the opportunities are enormous.

Let me step back and just look a little bit at our performance from last year. Clearly a very good year. PSG makes up over 32% of HP's revenue. We're growing right now at above market rate, above market rate for both in established and emerging markets. Just as importantly, we contributed a little over $1.2 billion in operating profit, or 3.9% of revenue. So outstanding performance from the team and an outstanding start for 2007.

And I think one of the things that's clear as we look at PSG and one of the things we've continually talked about is there are no silver bullets here, right, there's not one thing to do to drive continual improvement. But our performance is based on strong, disciplined execution. We worked very hard to put a cost structure in place that helps us drive competitive pricing, and we're never done.

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Our cost is never low enough. Our quality is never high enough. At the same time, we've driven our product portfolio to a very strong position that helps -- that's helped us win in the emerging markets and helps us win in the high-growth categories that made up 2006. And then, of course, we've expanded our go-to-market reach, both broadly and more deeply in the way that we've built a direct and indirect capability, and at the same time leveraged all the go-to-markets assets that Hewlett Packard has.

I'm not going to dwell on this, but I thought just a progress report was in order because, as Bob indicated earlier, we've made enormous progress. But I think what we look at as we go forward and what I'm going to spend time on today is what are those levers that we'll pull. What are the areas that we'll focus on to continue to drive profit improvement, to continually drive profitable share growth and really get us to those operating margins, that 4% to 5% rate that Bob talked about, not as an end state, but clearly as a goal for the future that we'll continue to build on.

And I think before we get into that, I'll talk a little bit about a couple of trends that we see in the PC industry overall. [How] we see customer trends, [compete] technology drivers and then, of course, how the market responds to those. So when we look at the customer, clearly we see segments that are focused on mobility, on security, on the integration of hardware, software and services, and we really see the points that Shane mentioned, that both -- not just mobility is important, but connectivity becomes more important. And as we look at those technology drivers, clearly as we drive better performance, clearly as we drive more connectivity, that ecosystem that we enable is a huge driver to our growth.

Now, when we look at market trends, I think broadly from enterprise to small business to the consumer, we see a market driven by connectivity, driven by rich media, driven by converged devices. Converged devices being media center PCs, the wireless notebooks, the iPAQs. Client virtualization becomes more important as we look forward and how we provide a safe, secure flow of total cost model for the enterprise is critical.

And of course, I'll spend time on the emerging markets. India and China are important, but so are Vietnam and Indonesia, and as we look out three years, the importance of these markets to sustain growth becomes more and more important. And above all, above all of this, we have Vista launch a new operating system launched at the end of January that to-date we've seen have minimal impact, I think beginning to create some enthusiasm, but the results that we've driven have really been based on our ability to create awesome products at profitable price points.

So look, I thought I'd spend just two minutes, as we stood here last year, we talked about creating demand in the PC business. We talked about the importance of personal computing. And with that in mind, we launched a broad global campaign that really supported that belief that whether you're a consumer, a small business, or an enterprise, the computing experience is critical to you, and I think you'll see in this video that this has been embraced broadly around the world. So if you could, could you run the video, please?

[VIDEO PLAYS AND RESUMPTION OF SESSION]

So while the campaign is one piece of the success that we've driven this year, it really just emphasizes the fact that we're part of a broader ecosystem, that both the scale, the product portfolio and the diverse channel structure that we drive at HP is helping us win and we are winning in the market.

The current trend clearly supports our global strengths, our strength in the consumer market, in the notebook market, where units grew almost 41% last year, and the established foundation that we have in these emerging markets. These are all places that we have leadership positions today and we'll continue to build upon as we go forward, and as we look at how we drive efficiency in our model in many of these that Mark talked about and Bob talked about, you'll see us continue to price very aggressively, continue to drive that profitable growth that's so important, and at the same time invest in spaces that are critical for future growth like client virtualization.

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I'm going to spend a few minutes and take you through the four-part -- four-block, if you will, strategy we've put in place to drive success. The first block is clearly a strategy, or clearly lays out the foundation of the strategy, built on operating efficiency, how we continue to drive cost out of our business, through improved product quality, improved delivery performance, lower supply chain costs and, of course, ongoing warranty reduction, and as Bob talked about earlier this morning, making those very, very smart data-driven decisions about logistics, about procurement and about how we drive cost out of this business going forward. That's what gives us the fuel to be as competitive as we've been. That's what gives us the fuel to continually invest for growth and to expand margins.

The second part is really how do we continue to grow in our core. In 2006, we shipped slightly over 35 million devices around the world. But as we look going forward, there are clearly places where we just haven't shown up in PSG, the education vertical, the second and third-tier cities in some of the emerging markets. SMB was as much of a solution around what drives the small business market. And how we leverage our global partners to create an even stronger footprint of both channel partners, retail partners and our direct capabilities. So all of these create very natural extensions of our core, clear adjacencies and clear geographies.

Now, as we think of what are new positions that we want to take in very, very attractive markets, we've rekindled a focus on innovation in PSG. We've refocused an effort around innovation that matters to customers and that customers are willing to pay for. Now, we've always been an innovator. We lost a little bit of that over the course of time, but now we've reset that bar both for ourselves and for the marketplace, and whether you look at anything from our blade PCs to our media centers to the new MediaSmart television, we're looking more aggressively than ever at how do we leverage that technology invested in HP labs and that very unique capability that we have that none of our customers can match -- none of our competitors can manage to bring a very innovative solution to market that matters to people.

Now, when we talk about continuing to drive ongoing efficiencies, profitably gain share in our core, drive new businesses, clearly all this needs to be built around the best customer relationship, the best customer experience in the industry, and as you look at the success that we've had in 2006 and the success we plan to drive further, it's really built on a continual environment of improving customer satisfaction, both from the quality of the products we ship to the event where we have to provide support, and great products make for a great experience.

We'll also be continuing to look at how do we add that solution that's important, how do we drive value through our resellers and how do we continually expand our retail footprint, because it's very important to let customers shop and buy where they want to buy as opposed to trying to drive them to one channel or the other. And I think one of the themes for the day is we still have work to do, that we are transforming, and I think that's very fair to say of PSG as well.

I just wanted to give you a look at what some of those areas are, and I'll talk about each one of these in a little detail that really we think represents those opportunities, because as we push these levers for results, you know, this is much more than just bring in an AMD processor. We very strategically created a competitive environment for our vendors, created a win for our customers by providing a choice between an AMD or Intel solution. While lots of people have written about this year the fact that we embraced AMD. This is a 10-year relationship. All we've done is created a larger market opportunity for our customers to take advantage of that technology that matters to them.

So, as we look at our improvements to date, clearly we look at attach rates and how do we drive greater attach rates going forward. We look at lower costs from logistics. We look at how do we hubs and suppliers and really drive forward to a benchmark cost structure. So I'm going to spend a few minutes now and just go through each one of these for you just to give you a sense of the amount of focus that we've brought to these.

I think our consumer strength is second to none. Clearly, our marketing campaign has created energy, but at the same great products, superior design, features that matter to people like QuickPlay, creating categories with MediaSmart TV and services like HP Total Care are all things that both differentiate us and at the same time provide the opportunity to drive margin. We

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have a great brand position right now with both HP and Compaq, and how we continue to leverage that across our multiple channels will both provide a differentiator and a competitive weapon as we deal with both existing and new competitors.

From a mobility standpoint, clearly the fastest growing category in the PC space, and if you narrow it down even more, consumer notebooks grew at an awesome rate last year, and what we believe is that it's not just mobility that's important, but it's that ability to connect that's important, that ability to connect in a safe, seamless way, that matters to customers.

Now, when it comes to connectivity, we offer multiple solutions. We provide three layers of security, and we make that connective solution both safer and easier for consumers, for small business people and huge enterprises, and, as we look at performance over the past year, by Q3, the combination of great products, great design, breadth of distribution have driven us to the number one notebook position in the world.

When we look at emerging geographies, clearly these will account for a larger and larger piece of the PC market going forward. We'll leverage the foundation that we've created versus many of our competitors. We've been in China for 21 years. We've been in Vietnam for 10. So our ability to leverage that long-term local presence is essential to success because you have to have more than just a sales experience in these markets. We'll look at how we leverage both our local partners, the local retail structure and the go-to-market capabilities that we have in these diverse markets to both expand and to win where we already are.

So this is a -- this is one of the key drivers, both from a growth perspective, but also from a competitive perspective. As we take that beachhead and take it away from some of the growing Asian tigers, I think we'll be very well positioned to win going forward. Attach is a key piece of our margin growth going forward. Clearly, we'll drive profitable margin in our core business, but our ability to attach both products and services that expand the computing experience are essential.

You know, there's data from IDC that indicates that 30% of attach happens after the point of sale, 30% of attach happens within those first 90 days of ownership. So as we look at how do we increase registration, how do we provide a simple way for customers to begin to create a relationship for us -- with us.

That becomes one of the key elements of success, and as Randy executes the data warehouse model that he talked about, our ability to engage with these customers on an ongoing basis will be both critical and a key driver to success, success from an ability to attach, success from an ability to resell and success from an ability of really marketing to that installed base, and we know that these value-added services and these value-added products with the partner base that we have will continue to generate strong margins and exceptionally high customer satisfaction.

So with that, I'd like to summarize our strategy in kind of four key words. I think clearly we've laid out our ability to drive profitable growth in CSG. We've talked about some of the areas today that are important for both margin growth and unit growth. So let me just sum this up in kind of four key words; efficiency, expansion, innovation and inspiration.

Obviously, efficiency is just a must for survival. It's just the way we live and it remains the foundation of our business. It creates that room for expansion, both geographically and into new categories that's so important. It also provides that ability for us to continue to invest in innovation, that innovation that matters to people, and I think, as you saw from that video, that very brief video, we're also about inspiring people. Inspiring to get the most out of this technology that they've acquired from us, inspiring them to create that personalized computing experience.

So at PSG, I think it's fair to say that the story's just beginning. We still have a lot of work to do, but we're doing it on a very strong foundation, a foundation built on efficiency, built on global scale, built on focusing what matters to customers. We've made the transition from really struggling, if you will, if you look at that second chart, really a lot of big red bars, to surviving, to now thriving. And with all that, I'd like to thank you for your time, thank you for your attention, and turn this over to VJ.

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VJ Joshi - *Hewlett-Packard - Imaging and Printing Group*

Good morning, everybody. What I want to do is talk about imaging and printing. So 2006 was a good year, if think about $26.8 billion revenue, 6% growth, 14.9% operating profit, expansion of margin by 1.3 points, $4 billion in profit. But at the same time, we had 12% unit growth. Fifty-four million printers were shipped in 2006, 41 million inkjet, 13 million laser jet.

Our supplies grew 10% and if you think about the market share, which is a very important aspect of our business model, we gained five points of market share. Really having that kind of market expansion and gaining share without really pricing, focusing on innovation, focusing on the right sockets so that we can enjoy the [new strengths] is the real story in 2006.

Our customer satisfaction is very important. Todd talked about it. JD Powers and PC Magazine, for the last 15 years, we are number one. I think that's the story in 2006. If you think about it, for imaging and printing, we have been consistently executing strategy. This is a slide I showed in 2002, June. We are shifting from printer to printing. We are focused on pages. We are focused on any page which is printed. As things go from analog to digital, opportunity for us.

Think about photo to marketing collateral to signage. When you walk here in Times Square, all the billboards you see, opportunity for HP. For Mexico, at election time, the billboards you see, opportunity for HP. That's what we are focused on. Think about from 2001, our revenue was 19 billion, 26.8 billion, five years, growth of 6.4% in revenue. We had $1.9 billion operating profit. We've doubled the profit 14%, operating profit growth in 2006.

We are not done yet. As Mark talked about, we have a lot of work to do. We have tremendous opportunity in front of us. What we need to do is take the cost out, focus on the opportunity, invest in the opportunity, continue to grow imaging and printing.

So from a growth strategy, it's very simple. As I mentioned, look at the pages, 46 trillion pages printed in 2005. That number will go to 52 trillion. 8% was what we were focusing on. In 2001, it was only 5%. So we've expanded our addressable market. That addressable market will continue to grow to 10%.

As things go digital, even though page growth here is only 2.5%, the digital page growth is 7% to 8%. That's what we want to go after. That's where the opportunity is and it's from both hardware, supplies and services. That really determines our growth strategy. Growing faster than the market over core market, that's what you saw, definitely growth in our market share. Emerging geographies, just like Todd, is going to be very important for that.

Go after the photo market, go after the copier pages, fax pages, all the pages that we can capture which are going digital, from the information point of view. Marketing collateral, industrial printing, all those things will have a tremendous opportunity for our supplies. That's a simple way of tracking the pages and the opportunity for us and the growth strategy

Let's talk about each one, each growth strategy, what we have done and what we need to do. Starting in the growing faster than the core. As I mentioned, 46% now of our market share, five points gain. The inkjet market share that we built with a unit growth of 10%, in a tough market.

If you take our market growth out, I think market declined. Very tough market. We absolutely believe with innovation, we can continue to grow our units. Laser units are up 19%. We absolutely believe we have the best product portfolio in the laser business. What we need to do is to continue to drive the innovation and continue to really come up with better solutions and services so that we can make this the technology of choice for office and enterprise markets.

When we look at our strong unit growth, the supplies need to follow. That's where we are becoming very selective with respect to where we put our units in high usage markets, so that we can see the results of that hard work that we put in. Our unit growth will blossom into supplies. The important part here is, as Mark mentioned, in last two quarters, we had 15% and 17% unit growth while maintaining 14% to 15% operating profits. We must get the cost down and reinvest into unit growth and the new opportunity.

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Now, when you think about market share growth when we are already leaders by a big margin, 2X to 3X margin, that's a hard thing to do, because you could easily destroy the market. The approach we have taken is through innovation. The approach we have taken is really driving that market share growth, understanding and meeting the customer needs. Think about every single category, we gained share. The inkjet side, with all-in-one, single function, overall six points of growth in the market share. Mono laser, three points, substantial market share gains in color, eight points.

In MFP and all-in-one in laser side, we are number two. Our objective is to be number one. Stay tuned. We will be number one, because that's what we believe our technology and all our understanding of the market will yield us. In terms of the large format business, we also have a tremendous share with Scitex now, with Indigo. We are gaining share in industrial and commercial publishing.

Let's talk about digital photo strategy. Our objective initially was, with inkjet, you could print photos in the home. That's where we started and we gained a lot of share and a lot of growth in photos by printing leadership in the home. As you can see, from 2002 to 2006, digital prints grew 27%. A lot of that growth came through our home printing leadership. As Shane talked about it, printing photos at 12 seconds, it was the scaleable printing technology that allowed us to get that leadership really established and we will continue to drive home printing.

But we felt that we need to also participate in another part of the market, the portion about consumer printing. We absolutely believe the consumer is a very important part of the market segment. The approach we have taken is we want to go online. We acquired Snapfish. We also want to build infrastructure. As these retailers go from analog to digital, they need online capability. They need back office capability. We acquired Silverwire.

So now we can go to a retailer and say, "We can help you. HP is the only company that can help you to build your online, your back office, give you digital printing solutions." They could also manage their analog. That's the power of Silverwire. And this is not a random walk. They need to integrate all that into their IT infrastructure. HP is the only company that can also provide the IT infrastructure.

That's the reason we have been very successful right now with our retail buyers, companies like Wal-Mart, Jessops, globally are coming to us and saying, "Help us. There's a transition going on. The analog systems are declining very rapidly. Can you help us? Can you help us to build the online assets? Can you help us to build the back office so that we can really take our current assets and utilize them very productively?" We are working with 40 retailers right now in building that overall system for retailers.

So now think about it. We continue to grow our home photo printing. We are establishing leadership in our online capabilities. Snapfish is the engine with Wal-Mart, is the engine with Walgreen's, is the engine with Costco, is the engine with Jessops. We will continue to go to other parts of the world, to Australia, to other European countries, because we absolutely believe we are the leader.

And that, with Silverwire, we are going to build the capability for retailers to transition into digital. How we're going to get all the photos, not just the photo printer in the home, but online and the retail. So you can see about our transformation going from printer to printing. This is the proof point, we're going to go to printing infrastructure, the IT infrastructure, leverage our capability from Hewlett Packard and go from pages and how you create and consume those pages, that infrastructure.

If we could do that for photos, we could do that for marketing collateral, we could do that for signage, we could do it for every aspect of the page which is printed. Think about copier pages. Again, we always were number one in personal all-in-one space. We wanted to go into the high end. Remember, I've been talking for two years about this is a opportunity for us.

We went from no market share to 18% market share just within two years with our breakthrough technology with 4345 and now we have built a complete product portfolio. We feel that our success here is very important. We want to build a product portfolio so that we could actually help in having the right infrastructure, from small and medium businesses to enterprise businesses.

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Then we want to make sure that we manage the environment for them and then we want to look at all the paper-based processes and help them to make their knowledge workers more productive and take an extensive amount of cost of their operating of imaging and printing. We also believe that inkjet technology has a place here. Shane talked about the scaleable printing technology. In 2004, we introduced our first scaleable printing technology in home printing. Then we took it to small and medium business.

Then this year we took it to the retail photo finishing. I'm going to show you a video to talk about where we can take this technology. Please roll the video.

[VIDEO PLAYS AND RESUMPTION OF SESSION]

VJ Joshi - *Hewlett-Packard - Imaging and Printing Group*

So I think the important part for scaleable printing technology is the same equipment set will do a consumer printer, a small and medium business printer, a retail photo kiosk to light production, going into industrial. That's where the pages are and we want to use our inkjet technology to get the high performance with the cost structure of high volume. That's how we can continue to grow our revenue and profits.

Let's talk about the enterprise opportunity Mark talked about. Just for 2,300 top customers for HP it's $72 billion spent right now in imaging and printing. Now, we do have high share on single function, but on services, on software, with respect to the multifunction printing, our market share is very low.

The product portfolio that I talked about and leveraging the TSC organization, we can go after this opportunity in a very big time. We already started that. We have a $2 billion contract value in printing services. We absolutely believe this is a tremendous opportunity for us. For last year, we are building a team here. We are hiring salespeople so that we can go after this opportunity.

And the way to think about opportunity is it's basically how do we optimize the infrastructure for the customer, how do we manage the environment, and then go look at the paper-based processes and improve the workflow. The approach we are taking is we know the market is shifting very rapidly. These conversions of copying and printing is creating the opportunity and the market is coming to us, because the CEOs are saying, "Let's get the cost out and improve the productivity." Let's not have this battle between facility department and IT department. Let's make sure that we have a unified strategy for imaging and printing.

We also know that we need to make sure that we come from the customer point of view. So what we are doing, we are sub-segmenting the market, looking at the vertical market, where paper-intensive properties are there, where we know that we can go and look at these processes, completely reconstruct and reconstruct based on improving the productivity and effectiveness. We absolutely believe that we can help the company. We already have done that for companies like GM. We absolutely believe that we can improve the productivity by 20% to 30% and take cost out 20% to 30%. That's the opportunity.

And we believe that having a solution and services approach, in addition to the approach that we have taken with imaging and printing technology innovation, will create a unique opportunity for Hewlett Packard. If you think about managing the environment, our management team has 75% market share. It's higher than our MFP market share. The reason is we have the best tools, we have the best processes.

So this opportunity is big and we are going to get there. We have a lot of work to do, but we are convinced that we are going to make that happen. The next opportunity is capturing the marketing collateral, two parts. We've got laser jet doing do-it-yourself marketing. Another one, working with print service providers and ad agencies, with enterprise segments. This is a tremendous opportunity.

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The acquisition of Indigo is working well. As you saw, we gained 10 points of market share in Indigo, went from 36% to 46%. Our page growth has been 37% to 40% per year. We said there is a shift going on, especially in the short term marketing collateral creation and consumption. We absolutely believe that this market is going to continue to grow at 30% to 40% and we are number one. We are going to continue to drive our revenue and profit growth.

The industrial market, here we have three very important plays. With Designjet, we are the leader. We have 54% market share. We continue to drive our entry into this particular market aggressively. Scitex, that Shane talked about, the acquisition, really allows us to go after big billboards and point of sale. The approach we are taking here is trying to really understand how billboards are done.

I went to a customer in the Los Angeles area. They were doing billboards for movies. The interesting thing was they were doing printing digitally and they would use 1,800 to 1,900 carpentry process of drilling holes and making a billboard. We think that we can really help even looking at that whole process and help them to become more productive and more useful in conveying their brand image very effectively. Industrial printing also is about labels, where Indigo, Scitex and Designjet can help, tremendous opportunity for us.

All these opportunities drives supplies market share and we are very focused in making sure we continue to grow our supplies. We are developing new products, some specific products for emerging markets, multi-pack, so the customer will have, who are using a lot of ink, a lot of toner, the right kind of cost-per-copy approach. We're looking at reliability is a key for our original cartridges. They are 50 times more reliable for color toner and color ink, 10 times more reliable for black and white ink. We will communicate that message.

We will work with channel partners, as Mark talked about, in a differentiated way. So that if they work with us, we are able to reward them. This is very, very important for us. Supplies is going to continue to drive our profitable growth for our organization. So in summary, imaging and printing, 4% to 6% revenue growth and now we are seeing 14% to 15% operating profits. We believe that the costs that we have taken out, the company has also focused on making sure that we have the right cost structure for this business. Investing into that, drive that revenue growth, and maintain that 14% to 15% operating profit.

Thank you very much. I'm going to invite Todd and Ann and we're going to take questions.

QUESTIONS AND ANSWERS

Brian Humphries - *Hewlett-Packard - Vice President, Investor Relations*

Thanks, VJ. Thanks, Todd and Ann, for joining, as well. Just in the interest of getting as many questions as possible from the audience, can I ask that we refrain from multi-part questions, so we can move through the process as quickly as possible.

Once we get through the next 30 minutes or so, I'll ask Mark to come to the stage to wrap up the presentation and, again, there is an interactive luncheon just here on the right-hand side of the stage for 45 minutes between 12:15 and 1:00 p.m.

With that, we'll take the first question. Bill Fearnley.

Bill Fearnley - *FTN Midwest - Analyst*

Bill Fearnley, FTN Midwest. A question for Todd here. When you look at PC pricing and when you look at you're trying to expand the margins in PCs, what are the things you're looking at to improve the operating margin in the PC space? Is it leverage? Is it cost of goods? Is it attached? What are the biggest leverages here as you try to improve operating margins '07 to '08? Thanks.

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Todd Bradley - *Hewlett-Packard - EVP, Personal Systems Group*

Well, I think it's all of the above. Clearly, leverage from the breadth of scale that we bring from the multiple go-to-market channels that I can leverage that we already have in place, the attached business is a critical piece to expanding those margins, and then, of course, just the leverage we have taking costs out of business broadly. So like we've said, there's kind of not a silver bullet here. You have to actually queue in on all three of those effectively in order to make that happen.

Ben Reitzes - *UBS - Analyst*

Ben Reitzes, UBS. VJ, you kind of raised your target range for operating margins a little bit, 14 to 15 instead of 13 to 15. Can you just talk about why? What gave you that confidence? And then could you just talk a little bit more about what that means for pricing? Lexmark's recently said that pricing is a actually more benign. And what does that imply for HP's price aggressiveness going forward?

VJ Joshi - *Hewlett-Packard - Imaging and Printing Group*

Well, I think the important part for us was focusing on taking the cost out and reinvesting. When we look at our models for the next three years, because it's all determined by how we're going to grow with supplies, that and then taking the cost out, those two things give us confidence to really raise it from 13% to 14% for the low range and really keep our high range at 15%.

With respect to pricing, again, we are not focused on pricing. We want to go after the right sockets, where we can have the right usage. That's our focus and that what's we are doing.

Todd Bradley - *Hewlett-Packard - EVP, Personal Systems Group*

But I think the other thing I'd add to VJ's comment is as far as where we've bundled printers and PCs, and that's been a great bridge between the two businesses. As we go forward, clearly, we'll continue that, but our ability to help drive that distribution of Snapfish, to make Snapfish easier for customers to access and use, just benefits the printing businesses, obviously, and HP overall. So we think both those bridges, as VJ and I, our respective teams have worked through this, represent a great opportunity.

Brian Alexander - *Raymond James - Analyst*

Brian Alexander, with Raymond James. Todd, on PC profitability, your profitability is pretty close to the industry leader. How much of a cost disadvantage would you say relative to Dell or benchmark do you think exists today and how might that vary by foreign factor or geography?

Todd Bradley - *Hewlett-Packard - EVP, Personal Systems Group*

Well, we know we have some work to do to get to benchmark costs. I'm not going to go into specific numbers. I think, at the same time, we know those levers that I talked about, that we'll pull to continue to drive costs down in that core business. I think there are other advantages that we have over Dell that are significant from a go-to-market and the flexibility that we've built in our model by not owning those manufacturing assets.

At the same time, there are other low cost competitors out there, like the Acers of the world, that we're probably as focused on. We always talk about Dell in these sessions, but there are a broad range of low cost competitors that we've taken share from and I think that we'll continue to take share from in these emerging markets. But one of the keys to growth is not just the natural

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growth we'll get in these markets, but it's competitively taking its theme away from the Lenovos and the other Asian competitors before they gain scale.

Harry Blount - *Lehman Brothers - Analyst*

It's Harry Blount from Lehman. I'm going to follow-up on a question I asked Mark earlier. The consumer market looks like, in round numbers, a 200 to $250 billion market. If I look at how you guys are positioned, it looks like you're the number two player in retail globally. You didn't really give a lot of details in terms of the opportunity sets you guys see beyond the PC segment. I guess I'd ask VJ the same thing.

You guys talked a little bit about Snapfish, but didn't give a ton of details. I'd love to hear a little bit more on consumer broadly.

Todd Bradley - *Hewlett-Packard - EVP, Personal Systems Group*

Sure, I'll start and then I'll let VJ come in. Look, we think the consumer market clearly is hot right now. It plays to our strength of that multi-channel capability that I've talked about. It's played to our strength of being a strong notebook provider, building products that are exceptional from a quality perspective, from a design perspective, from an innovation perspective.

So one of the drivers, clearly, we've seen for the growth we've had in that piece of our business this year. As we go forward looking at consumers, clearly, we think about things like storage, and you saw us announce and launch a product we call Media Vault. That's a very safe, simple way for a consumer to store all the content that they're now creating. One of the drivers to mobility is, obviously, access to rich media, but at the same time, you need to store that. So we've taken a focus on storage in the consumer space.

And then in the managed home space, we've launched the MediaSmart television. MediaSmart is a television that has an IP address that will wirelessly connect to other products in the home and become really the hub of that managed home, which we believe to be it. I'd tell you we're probably a year ahead of anybody else. I know Apple has talked about iTV. That will come next year, kind of a box with plugs.

We, through an engineering effort, really focused on how we create that in one seamless unit. And we'll tell you we have, I think with any kind of first generation product, we're working hard with our retail partners on how we sell this and how it gets positioned for its capabilities instead of just compared on a price per square inch basis.

So I think, Harry, to summarize, great strength in the consumer market broadly around the world, new products coming, I think more and better features coming on the PCs that we sell today.

VJ Joshi - *Hewlett-Packard - Imaging and Printing Group*

I think building on what Todd said, first of all, we own 10% of all the retail space globally. So we are number one from the IT category point of view from Hewlett Packard. There's no other company that can even come close. I think what we need to do is really utilize our footprint that we have into new product categories. I think we need to make sure that we continue to innovate and drive where the growth is.

So the first thing is, as Todd talked about, we're going to continue to drive our laptop and our new categories, like TV, into that growth. The second important part for us is photo. I think photo is a tremendous opportunity, not just printing in the home, but retailer-based or online-based, where consumers will go and have a choice from HP with respect to the photo.

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Now, we think that photo is a starting point and the way you think about photo is a still image into moving images. I think we believe that video is also going to be a very important opportunity for us and we are going to partner together in making sure that that opportunity will be fulfilled with Hewlett Packard innovations. The next thing is what Todd talked about from the storage point of view. I think all these memories, if they want to store them and they want to really make sure, as things move from PC to the web, are we going to really have the right kind of Web 2.0 solution.

So when you think about Snapfish, don't think Snapfish as just a service photo. It is really the first entry into Web 2.0 based services that we will be able to establish and take and extend them into various aspects of the media and working together with Todd is going to be very important for us. So think about the IT, think about photo, think about videos, and entertainment, I think that's where we want to go and we need to just go systematically, because we don't want to do something where we will not be able to drive both revenue profit. So we're going to be very systematic, use our usable footprint and that's how we're going to continue to grow the consumer business.

David Wong - *A.G. Edwards - Analyst*

David Wong, A.G. Edwards. A question for Ann, I guess. Can you explain to us a little bit about x86 market share dynamics? The last couple of years, HP, arguably, has made some very clever decisions. You were early in AMD. You were strong in blade. But there's no obvious market share gained by HP since, say, 2004. Would you disagree with that market share figure or is there some reason why this translates to go into the future?

Ann Livermore - *Hewlett-Packard - EVP, Technology Solutions Group*

If you look at the x86 market over the last several years, HP has retained our number one position from a market share perspective. And part of what you saw us do over the last couple of years is go through, as we made changes to our business model, tradeoffs between share and price. So we did make some share and price tradeoffs. We've gotten to a point now where we're really comfortable with the cost structure we have and the position we have in the marketplace.

So you've seen some good results from a growth perspective for us relative to the competition the last couple quarters. If you looked at both Q3 and Q4, we outgrew both IBM and Dell in those quarters. So that is really playing to our strategy of getting the cost structure in line, making those tradeoffs, and now using it to be able to price to win from a share perspective.

There are also interesting dynamics in the x86 market, where many customers are starting to look at the total cost of ownership advantages of blade, and more and more wrapped decisions in the past now being solutioned instead by blades. So that's why we see so much focus and importance around blade.

Tony Sacconaghi - *Sanford Bernstein - Analyst*

Yes, it's Tony Sacconaghi. I have a question for VJ, please. You talked quite a bit about the scaleable print technology. Can you comment on, in the copier and enterprise phase, what you think the relative user cost advantage is of SPT and, ultimately, if you are successful with SPT, isn't that incremental? Doesn't that provide an incremental boost to margin given the technology?

VJ Joshi - *Hewlett-Packard - Imaging and Printing Group*

I think the scaleable printing technology, we're going to be very selective. We are very successful with our laser business and we need to continue to grow our laser business. We think that scaleable printing technology has a place in the low end of the market, with the photo printing and small and medium, the micro business printing, and then in the high end, where we want to go towards light production, because there is a gap between the high end of the laser and our Indigo portfolio. So we need to really build that gap with injket.

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And I'm not going to tell you right now about specifically what cost per copy you could expect. Stay tuned. This is going to be in the market next year. With respect to market expansion, we have a portfolio of businesses and what we need to do is to have the right balance between revenue and profit growth and we will continue to drive the profitability with ink and, at the same time, have the right portfolio from the revenue growth.

The last point is, as you saw, when you talk about liters of ink rather than milliliters of ink, that's exciting for us.

Bill Shope - *J.P. Morgan - Analyst*

Bill Shope, J.P. Morgan. A question for you, Todd. You briefly mentioned Windows Vista in your presentation. Could you give us a little more color on how you think the OS launch could impact demand in the PC business next year and also how it could impact component costs, mix of business and the like? And then, also, an extension of that, can you comment on whether or not you've seen any impact from the delay in the OS on holiday season demand.

Todd Bradley - *Hewlett-Packard - EVP, Personal Systems Group*

Maybe I'll start there first and work my way back. No, we haven't seen any impact on demand with the delay in the holiday launch. We haven't seen any holiday impact on demand with the delay in the launch of Vista. I think we've just really started to see consumer interest to start to pick up, mainly driven by the amount of in-store material now around free upgrades.

So we haven't seen any kind of impact on demand. Our demand has been well within our expectations and strong through the holidays. From a cost perspective, obviously, Vista will take little more of a memory footprint. We know that. We've built that in. It's made the memory market somewhat tight here in the short term, but I think we're pretty well on the way to being beyond that.

And I don't think we expect enterprises -- of all the enterprise meetings that we've had and all the customers we've talked to, we don't see Vista as a huge growth driver in the enterprise. I think customers -- consumers, consumers will see it as an advantage as the product gets launched, but we don't see any kind of that steep drop-off, pickup that we may have seen many years ago.

So I think it'll be a very smooth transition. I think it will create some excitement in this space in the spring, but we're not looking for any kind of anomalies of huge lift or huge supply issue.

Richard Farmer - *Merrill Lynch - Analyst*

Richard Farmer, Merrill Lynch. A question for Ann and Todd both on thin client architectures. It seems like it could affect both of your businesses. If you talk to enterprises these days, it seems like thin clients are getting a lot more traction recently. If it takes hold, potentially it could be good for your server business end, but potentially very deflationary for your PC business, Todd, on, I guess, the segment accounting. So how do you expect that to play out and what would be the effects on your businesses?

Ann Livermore - *Hewlett-Packard - EVP, Technology Solutions Group*

Well, we certainly see, with the thin client, a great both services opportunity, as well as the server and storage opportunity that it creates for us. But you're right that it will generate some interesting architectural changes that we can work through with our customers, as well as unit sales for us, whether they go with the bladed environment or they're a more standard, traditional server and storage type implementation. We are working on some of those projects today and have seen good opportunities associated with it.

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Todd Bradley - *Hewlett-Packard - EVP, Personal Systems Group*

I think the only thing I'd add to that, Richard, is that we do look at this from a segmentation perspective, multiple types of virtualization. We've created a product called CCI, Ann and Scott have the series of products, and we started to look holistically at it from an HP roadmap perspective and an HP go-to-market perspective.

So we're kind of hitting every one of those categories in the marketplace. So I think, frankly, leading in virtualization as a company positions is very, very well as we look at those customers that are desk-mates.

Ann Livermore - *Hewlett-Packard - EVP, Technology Solutions Group*

And we're one of the only companies in the world that can blade everything. And as you look at that as the forward-going architecture that many corporations are going to use, the fact that we can blade storage, we can blade servers, we can blade PCs, we can blade workstations, and then a bladed environment tends to have a higher average selling price than a rack from a server's perspective, because your software is bundled in with it, as well, and your services you can sell along with it. So it's a strategy advantage and portfolio advantage that we can blade everything.

Shannon Cross - *Cross Research - Analyst*

Shannon Cross, Cross Research. A question for VJ on the copier business, the MFP business, what you're doing with Edgeline. As you move into this new market or expand up, what are you going to do from the standpoint of services and support? Because when you look Xerox, they have a significant services fleet.

You partnered with ICON and Danka, I believe, in the past. And I'm just curious, I think a lot of it's user replaceable, but even so, things break, so as you move further into the office, how do you do the four-hour turnaround on that?

VJ Joshi - *Hewlett-Packard - Imaging and Printing Group*

I think the important part here for us is this tremendous opportunity. Todd talked about it and I talked about it, we are partnering. I think that's the expectation. I think that's what Mark said and that's our expectation that we are going to show up very aggressively, because we have the core competency here. We have now the product portfolio. We have a sales force. We need to go and execute.

Ann Livermore - *Hewlett-Packard - EVP, Technology Solutions Group*

And the interesting thing is if you think about our position, we're providing services for the end user environment already. We're supporting the desktops. We're supporting the LAN environment. We're supporting the connection back to the applications that the end users are using.

The print thing is a natural extension for us associated with it and the fact that you want to manage the printers from the server over the network flows into, again, the capabilities that we've had with the services organization across that entire infrastructure.

Shannon Cross - *Cross Research - Analyst*

Just to follow-up, right now, with all your managed printer services contracts, are they being done by people at IPG and/or are they being done within your group?

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VJ Joshi - *Hewlett-Packard - Imaging and Printing Group*

The approach we have taken is we do the sales part. All the delivery is done in HP services. That's where it belongs.

Ann Livermore - *Hewlett-Packard - EVP, Technology Solutions Group*

And for the really complex, big outsourcing arrangements, we'll have solution architects from our services team who are laying out the architecture be part of the pursuit team.

Lou Miscioscia - *Cowen and Company - Analyst*

My question is for Ann. This is Lou Miscioscia from Cowen and Company. Last year at the analyst meeting, you talked about the need to get your cost structure lower for services. Here you did say they actually got lower, but I'm just trying to understand how far along you think you are, because I think that HP was being a little bit more conservative on a lot of deals of managed services, as they tried to get the cost structure down. And maybe if you could comment about business conditions for consulting managed services in the pipeline.

Ann Livermore - *Hewlett-Packard - EVP, Technology Solutions Group*

There's several things bundled in that question. To your point about the cost structure, we still have a tremendous amount of work to do. Now, I mentioned to you the work around the data centers, the call centers, the labor costs and labor productivity, as well as the support delivery activities. All of those are still progress underway. You saw in the guidance that Bob gave just last year, our operating profits for HP services was 9.6% and we gave guidance for '08 of 11 to 13. So that speaks to some of the improvements we're anticipating.

Over the last year, we did slow down some of the growth in the HP services business, working on some of these cost structures, so we could price more aggressively, price to win and still deliver the margins that we wanted. We're seeing those as attractive markets. We think we've got a cost structure where we can price. But you'll see us on the managed services deals and, also, consulting projects be equally interested in the terms and conditions and managing the risk of those deals, because there's some deals you want and some you don't just based on the risk scheme of the implementation.

So I think that will be more in our thought pattern than do we have the cost that it's going to take to price to win. I'm comfortable that we have plans in place that put us in a good position there, but, still, as we said, a lot of work to do.

Rich Gardner - *Citigroup - Analyst*

Rich Gardner, from Citigroup. Ann, this one's for you. And we heard both Mark and Bob talk about the overall criteria for acquisitions for HP earlier and I was just hoping you could give a little bit more detail for services in particular. Would you be looking for acquisitions to beef up in domain and solutions expertise? Would it be scale, geographic coverage, customer relationship? Which of those would be most important to you in an acquisition target?

Ann Livermore - *Hewlett-Packard - EVP, Technology Solutions Group*

This is no new information that you're going to hear in this answer than what we've said over the last couple of years. For the services business, we look at hot capabilities where we want to extend our market share and add capabilities through acquisitions. We also look at acquisitions that help is geographically, if we want to expand in a market where we feel like we're better with

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an inorganic approach than an organic approach. So we look primarily around those two things, hot markets where we want skills and geographic coverage.

Mona Ariba - *Trust Company - Analyst*

Mona Ariba, from Trust Company of the West. It seems like printing at home between the notebook computers and photos, a lot of people are reducing their printing at home, I'm not sure if you've seen that, and moving more toward printing their photos at central locations or retailers or whatever. Do you see any dislocation because of this trend away from the home printing toward more -- ?

VJ Joshi - *Hewlett-Packard - Imaging and Printing Group*

I think printing is moving a little bit to retail, but still more than 55% of photos are printed in the home. It's a tremendous opportunity in the home, because more and more digital cameras are sold. So printing in the home for the photos is still a growth opportunity for HP. That's what we see.

Mona Ariba - *Trust Company - Analyst*

And the question to Ann regarding the blade servers. There are quite a bit of issues with the heat and the power consumption. I notice HP has built their own new data centers. So they address it from a data center building point of view. What do you see as the trend with the new multi-core and what kind of heat and power reduction are you starting to see? Are you seeing a lot of resistance or customers toward blade just because of those two issues?

Ann Livermore - *Hewlett-Packard - EVP, Technology Solutions Group*

I think as Shane mentioned earlier, when you look at power and cooling, there is work being done at the component level, clearly at the microprocessor level, at the server level, at the enclosure and blade level, and then at the whole data center level. So you have to be working on all those aspects of addressing power and cooling. When we introduced our C class blade server back in June, we made a dramatic improvement in power and cooling associated with the blade itself and it has given HP a very differentiated position in the marketplace.

But then we know customers have to address the other aspects, as well. So it's a great services opportunity for us around the assessment services and the design services for the data center. But you'll see work happening at every one of those component areas and this is an area where we intend to be the leader and are today in terms of the intellectual property we can bring to the table.

Unidentified Audience Member

Can you talk about, in printing, your market expectations for next year, how aggressive you think you could be on pricing to continue to grow your 500 basis points last quarter over year? And the second question is on a speculation of Lenovo's interest in printing and, particularly, with Lexmark, why you think that strategy, financially, I don't know if it's even feasible, but strategic interest in combining computing with printing?

VJ Joshi - *Hewlett-Packard - Imaging and Printing Group*

Let me address the second one first. We focus on customers and not competitors. So that's the answer. The first one, I think we want to continue to grow out to high usage customers. And in profits, if we can gain share because of innovations, so be it, but

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I think our focus is going to be high usage customers and we are going to be aggressive with respect to talking about the value proposition of offering. That's what we are focused on.

Ann Livermore - *Hewlett-Packard - EVP, Technology Solutions Group*

We have time for one more question.

Rebecca Runkle - *Morgan Stanley - Analyst*

Rebecca Runkle, Morgan Stanley. A long-term question, if you would, is you execute on all the strategy that you outlined today, it seems to me that you look more and more like IBM from an holistic standpoint. I'm just curious how you think about differentiating in the marketplace, again, from a long-term perspective as you build that portfolio out about services. What's the message in terms of differentiation?

Ann Livermore - *Hewlett-Packard - EVP, Technology Solutions Group*

Our position for our customers is that we're going to be the best at helping them manage and transform their IT environments and then be able to link that back to specific business outcomes that they're after. The management piece, we have a quite differentiated position than IBM around our software and our services focus specifically around management. Their software portfolio is in different spots than our software portfolio.

And then to transform to the new environment, we believe we are extremely well positioned. We don't have a dependence on our portfolio on mainframe profits to fund our progress forward. So our business model is not built on that. We also have a very strong position, as you heard, in the forward-going operating environment in the structures and the business models for the server and the storage business that we think is going to be required and, thus, the future data centers and the build-out associated with it. We have a very distinct position there.

So we're operating from a different point than them. We don't have the desire to have a portfolio like theirs. We have a desire to have a portfolio like ours and we think it's very well positioned toward the future trends of where the spending is going to be and you'll see us continue to focus on that. The areas we pick, the adaptive infrastructure, building the next generation data center, the enterprise management, with the BTO positioning and then, finally, the information management, we believe we have very unique capabilities compared to their portfolio.

We're going to invite Mark back to the stage to make some closing comments. Thanks.

PRESENTATION

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

I'm in between you and lunch, at least for the people who are here in the live audience. Let me close on a couple of charts that we've already talked about. First, I think, as it relates to the business model, if I were sitting in your chair, I'd start with what's the revenue growth going to be. And 4% to 6%, as I described to you, is a broad range when you roll that CAGR out three years.

I would tell you that the beneath the revenue line, provided the mix is roughly right, we're committed to taking care of our business. We will take care of our cost issues. We will deal with our profits opportunities. I would reiterate, and I don't want to undersell this or oversell this, I just want to make sure you get the appropriate perspective, we are a company that is transforming.

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We are not transformed and I would not get over-excited about 2006 nor would I want to understate the importance of what the company accomplished in 2006.

We need to really get about the job of executing. I think the pools of revenue available to us are clear. I think the opportunities for us are real. I think the issue will be can we get about the job of executing and I think we've laid out for you the things that we have to do to make that happen. So I'd close by saying I do think we made progress in '06. I do believe the market trends are playing to our strengths, but it's important for us, as even the questions that were just asked, to not only follow those trends, but actually to lead them and drive them, and we have an opportunity to go do that.

And as I've already mentioned, we will take care of, I think, the majority of the rest of the issues that we've laid out as it relates to cost, our capital structure, et cetera. So let me close by thanking everybody on the web for joining us. We appreciate it. Thank you in the room. For those of you in the room, there is a lunch next door. Because we are very concerned about our costs, I wouldn't expect a big great lunch. We have gray tap water from New York that we brought for you. That's a joke.

So the stuff is next door. There will be HP people at the lunch that are available to talk, as well. So, again, thanks for joining us. We appreciate it.

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