FINAL TRANSCRIPT

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HPQ - Q1 2008 Hewlett-Packard Earnings Conference Call

Event Date/Time: Feb. 19. 2008 / 5:00PM ET

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the first quarter 2008 Hewlett-Packard earnings conference call. (OPERATOR INSTRUCTIONS). As a reminder, this call is being recorded. I would now like to turn the call over to Mr. Jim Burns, Vice President of Investor Relations.

Jim Burns - *Hewlett-Packard Company - VP of Investor Relations*

Thank you, Melanie. Good afternoon and welcome to our first-quarter earnings conference call with Chairman and CEO Mark Hurd and CFO Cathie Lesjak. This call is being Webcast live and a replay of the Webcast will be available shortly after the call for approximately one year.

Some information provided during this call may include forward-looking statements that are based on certain assumptions and are subject to a number of risks and uncertainties, and actual future results may vary materially. Please refer to the risks described in HP's SEC reports, including our Form 10-K for the fiscal year ended October 31, 2007. Financial information discussed in connection with this call, including tax-related items, reflects estimates based on information available at this time and could differ materially from the amounts ultimately reported in HP's Form 10-Q for the fiscal quarter ended January 31, 2008.

Earnings, operating margins, and similar items at the company level are sometimes expressed on a non-GAAP basis, and have been adjusted to exclude certain items, including amortization of purchased intangibles and restructuring charges. The comparable GAAP financial information and a reconciliation of non-GAAP analysis to GAAP are included in the tables and in the first-quarter earnings slide presentation accompanying today's earnings release, both of which are available on the HP investor relations Web page under company information at HP.com.

Finally, please refrain from asking multipart questions or clarifications during the Q&A. I'll now turn the call over to Mark.

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

We in the room are always motivated with Jim's openings, so I thought I'd pass that to you. Good afternoon. Thanks for joining us. HP delivered a strong first quarter. We had balanced growth and profitability across all regions and gained share in key market segments. Our performance continues to be driven by three important factors.

Significant cost savings to both fund our growth and expand our earnings. Two, our deployment of additional sales resources to capture incremental opportunities in the enterprise and mid-markets. And three, a diverse global customer base and a broad portfolio that's aligned with the growth areas of the market. Let me be clear. Our cost savings are significant and ongoing.

Now let me walk you through some highlights for the quarter. Revenue was up 13% to 28.5 billion. Non-GAAP EPS was $0.86, and that's up 32% versus the prior-year period. HP generated 3.2 billion of cash from operations, which includes the payment of a considerable annual employee bonus commensurate with our strong 2007 performance. And we returned 3.3 billion to shareholders through share repurchases. In addition, we announced our intent to acquire [Extreme Software], a leader in variable data publishing solutions.

Next I will give you a few of my thoughts on the state of the business, and then Cathie will review the numbers.

PSG continued to generate strong results, driven by expense discipline and our investments in blade solutions, management software, and data center services. PSG grew revenue 10% and expanded operating margin 2.5 points versus the prior-year period. I am pleased with our improved performance in this business and confident that we can execute against the significant opportunities that remain.

The Imaging and Printing Group delivered revenue growth of 4% and operating margins of 15.7% in the quarter. IPG results show strong execution in our core ink and laser businesses, and solid growth in both the graphic arts and the enterprise.

CSG produced another excellent quarter, growing revenue 24% and expanding operating profit 52%. Our commercial business delivered strong revenue and margin performance, augmenting our strength in consumer, notebooks and emerging geographies. According to the fourth-quarter industry data, emerging geographies accounted for nearly half of the PC units shipped in the market and over 60% of the growth. Our results reflect this trend, and we are expanding our presence in these developing economies.

Now I'll turn it over for a little more depth on the numbers.

Cathie Lesjak - *Hewlett-Packard Company - EVP and CFO*

Thanks, Mark, and good afternoon, everyone. Before I get into the numbers, I just want to briefly touch upon a financial reporting item. Each year, as part of our first-quarter annual financial review, we review our reported segments and make changes between these segments to reflect any organizational shifts between the businesses. As indicated in our Q4 call, beginning in FY '08, the business intelligence and information management businesses have moved into HP Software from ESS and services. As a result of this change, the revenue and operating profit and loss associated with these businesses has been moved from ESS and services into HP Software. I will discuss the impact to the HP Software P&L more fully in a few minutes when I talk about the segment results. Additionally, there are changes in PSG and IPG, but with no net change at the segment level.

A detailed [bridge] of these changes including historical data is available on our investor relations Web site, as well as furnished on a Form 8-K filed with the SEC. I want to be very clear that the changes do not impact HP's previously reported consolidated net revenue, earnings from operations, net earnings, or EPS. This should just be viewed as an annual fine-tuning of our financial reporting structure to better align it with how we manage the business.

Now moving onto the results of the quarter. HP began fiscal 2008 with solid performance and balanced operating profit growth. Revenue for the first quarter totaled $28.5 billion, up 13% year-over-year, or up 8% in constant currency. Non-GAAP operating profit grew 31% to $2.8 billion, or 9.9% of revenue.

Looking at revenue by geography, Asia-Pacific grew 22%, EMEA was up 15%, and Americas increased 8%. We generated 69% of total revenue outside of the US, with emerging markets driving significant growth.

First-quarter gross margin was 24.5%. Compared to a year ago, gross margin was up 80 basis points, driven by a generally favorable commodity environment, disciplined pricing, and improvements in warranty and attach.

Non-GAAP operating expenses for the quarter were $4.1 billion, or 14.6% of revenue, down from 15.1% a year ago. Adjusting for currency, expenses were up 6% as we added sales and go-to-market resources and absorbed acquisitions. We will continue to align our cost structure for greater efficiency and growth. Non-GAAP OI&E yielded income of $72 million, or roughly $0.02 per share. Our non-GAAP tax rate was 21% in Q1. First quarter non-GAAP EPS was $0.86, up 32% from the $0.65 that we reported one year ago. GAAP EPS was $0.80, which included $158 million, or $0.06 per share, in after-tax adjustments, primarily related to the amortization of purchased intangibles that were excluded from our non-GAAP results.

Now drilling in on the performance by business segment. During the first quarter, Imaging and Printing had revenue of $7.3 billion, up 4% year-over-year. Excluding cameras, revenue was up 5%. Supplies revenue grew 6%, and commercial hardware revenue grew 7%, while consumer hardware revenue declined 5% year-over-year. Segment operating profit was $1.2 billion, or 15.7% of revenue, reflecting gross margin expansion and favorable product mix.

We continue to see solid momentum in our growth initiatives. Our graphic arts business grew in double digits, and color laser and multifunction printer units grew 14 and 23%, respectively. Commercial hardware units increased 13% and consumer hardware units declined 2%. We continue to focus on targeting unit growth in areas of high supplies consumption, but do believe that we had more unit opportunities than we realized in Q1. Going forward, we expect to at least maintain share in the mature inkjet market, and see additional opportunities for growth in targeted areas such as graphic arts and enterprise printing.

Within IPG, we are also focused on reducing the cost structure and have a number of ongoing initiatives to improve supply chain efficiency and lower product costs. At the same time, we will continue to invest for growth and profitability through our commitment to research and development, targeted share gains, growth in graphic arts, and expansion of our enterprise printing sales force.

Personal systems had another outstanding quarter, with market share gains and strong margin performance. Revenue grew 24% year-over-year, or $2 billion, with unit shipments up 27%. We had a strong holiday season, with consumer client revenue up 29%. Consumer notebooks sold particularly well, demonstrating our strengths -- our strong product lineup, targeted marketing and the strength of our retail channels. Commercial client revenue grew 22%, reflecting solid demand in enterprise and mid-market segments. Overall, notebook shipments grew 49%, with strong performance in both consumer and commercial. Desktop and workstation units were each up 15%.

Segment operating profit for the quarter was $628 million, or 5.8% of revenue. Compared with the prior-year period, PSG operating profit increased 52%, or $214 million, reflecting solid execution, increased attach, and the benefit of a favorable commodity environment. You should expect us to continue to balance revenue growth and profitability by managing our costs, investing in marketing opportunities -- in market opportunities, and leveraging our strengths in notebooks, retail and emerging markets.

Moving onto technology solutions group. Enterprise Storage and Servers revenue grew 9% year-over-year to $4.8 billion. Within ESS, industry standard server revenue grew 11% and ESS blades grew 81%. Revenue in storage grew 10%, with the midrange EVA business growing 14% and the nearline business posting 4% growth after many quarters of declining revenue.

Business critical systems revenue grew 1% year-over-year. Integrity server revenue grew 37% and now represents 75% of BCS mix. ESS operating margin for the quarter improved 3.8 points to 14% of revenue, fueled by favorable component pricing, improved execution and expense discipline. While we are pleased with the progress we have made, we can still do a better job penetrating our addressable market. You'll see us take actions to drive go-to-market initiatives and add sales resources to expand account coverage and strengthen our customer relationships.

We had a solid quarter in HP services, with revenue of $4.4 billion up 11% over the prior-year period. Outsourcing and consulting and integration revenue increased 15% and 13%, respectively, while technology services revenue was up 9%. Operating profit for the quarter was $489 million, or 11.2% of revenue. We remain focused on balancing margin expansion with revenue growth. Our services results reflect improved focus on services attach, combined with operational improvement from our ongoing efficiency initiatives. We have made progress reducing our cost of service delivery, but we still have considerable work to do.

As I discussed earlier, beginning in Q1, we are reporting business intelligence and information management businesses as part of HP Software. On this basis, HP Software revenue was $666 million, up 11% from the prior year. BTO, formerly reported as OpenView, increased revenue 19% to $548 million, and other software, which includes OpenCall, business intelligence, and information management, had revenue of $118 million. Q1 operating profit for the segment was $51 million, or 7.7% of revenue.

For comparative purposes, HP Software would have reported revenue of $611 million and operating margin of 12.7% of revenue if we had excluded the impact of business reclassifications but included the impact of acquisitions. We have included a slide in the presentation that provides historical bridges for the business reclassification.

The software business includes a combination of nascent and scaled businesses. We are pleased with the progress the BTO organization is making integrating Opsware, and expect to grow this business as we help customers manage their IT infrastructure.

At the same time, we are expanding our information management and business intelligence businesses by investing in our solution portfolio and go-to-market presence. Similar to last year, we expect to expand profit margins as the year progresses, and are comfortable with the 20 to 22% operating margin for FY '09 that we outlined at our analyst meeting in December.

Finally, HP Financial Services had revenue of $642 million, up 17% year-over-year, and generated operating margin of 6.7%. We are encouraged with the growth in our core financing volume and portfolio assets over the last several quarters, as well as the strong performance in end-of-lease renewals and equipment sales.

Moving now to the balance sheet. HP-owned inventory ended Q1 at 33 days of supply. This is down six days compared with a year ago, reflecting our focus on improving execution and working capital management. With regard to channel inventory, we ended the quarter with PSG and ESS down roughly a half a week year-over-year, and IPG flat year-over-year.

Days sales outstanding increased to 39 days in Q1, from 37 days one year ago. Days payable was 47 days, down from 53 days last year. As we have discussed in prior quarters, we will continue to leverage our balance sheet to drive shareholder value.

Next, property, plant and equipment was up $759 million year-over-year, and down 20 basis points as a percentage of revenue. Gross CapEx was $611 million, down 15% year-over-year. On a net basis, CapEx was $523 million, down 10% from the prior-year period. Capital expenditures were primarily related to assets used in our leasing business and our investments in IT.

Moving onto cash balance and cash flow. Strong operational performance combined with ongoing focus on working capital metrics resulted in Q1 cash flow from operations of $3.2 billion and free cash flow of $2.7 billion. Included in these results was a significant FY '07 annual bonus which was paid out in the first quarter. In addition, we spent $3.3 billion on share repurchases during the quarter. Relative to prior quarters, the linearity of repurchases in Q1 was back-end weighted. At the end of the quarter we had roughly $7.4 billion remaining in the current share repurchase authorization.

Finally, we paid our normal quarterly dividend totaling $[206] million. We closed the year with a strong balance sheet, including total gross cash of $10.1 billion and net cash of $2.9 billion.

Now a few comments on our outlook for both the second quarter and the full fiscal year. We expect Q2 fiscal 2008 revenue to be approximately $27.7 billion to $27.9 billion. Similar to last quarter, and in light of the increasingly tough comparison [to] PSG, we do not believe it is prudent to set investor expectations that our personal systems business can continue to grow at this pace, nor do we think it appropriate to build a cost structure on that basis.

Given our significant international exposure, our results may be favorably or unfavorably impacted by currency. Assuming exchange rates stay roughly where they are, and given our assumptions about hedging and pricing, we expect full-year revenue will be approximately 113.5 to $114 billion.

Regarding earnings, there are a few variables to keep in mind. First, we expect the component pricing environment to be less favorable in Q2 than it was in Q1. Second, we estimate non-GAAP OI&E to be about $0.01 per share in Q2 and approximately $0.07 for the full year 2008. Finally, we expect to continue to repurchase shares in the coming quarter; however, likely at a lower rate than in Q1. Share count will be impacted by the share price trend, option exercise pattern, common stock equivalent, and repurchase activity. Currently we expect a somewhat steeper decline in Q2 and a more modest decline in weighted average shares outstanding in the second half of the year. With that in mind, we expect Q2 '08 non-GAAP EPS in the range of $0.83 to $0.84. For the full year we expect non-GAAP EPS to be in the range of $3.50 to $3.54, representing growth of 19 to 21% on revenue growth of about 9%.

So all in all, we delivered solid results in Q1 and increased our outlook for the year, reflecting the strength of our business model and our progress to date.

Before we go to Q&A, I will now turn it back over to Mark for a few additional comments.

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

Thanks, Cathie. While I realize that macroeconomic uncertainties exist, it's important to note that we control many of the levers that drive our performance. We are therefore confident in our ability to meaningfully expand our earnings per share. We expect to remove significantly more cost this year than we did last year. We will take these savings and realign our cost structure to fund investments that both improve the efficiency of HP and create growth opportunities. Combined with our strong balance sheet, broad geographic reach, and considerable recurring revenues, these factors allow us to comfortably raise our EPS guidance.

With that, Cathie and I will now take your questions.

Jim Burns - *Hewlett-Packard Company - VP of Investor Relations*

Let's take the first question, operator.

QUESTIONS AND ANSWERS

Operator

Ben Reitzes, UBS.

Ben Reitzes - *UBS - Analyst*

Good quarter. Wanted to just talk a little bit about the macroeconomic environment. Just going into the quarter there was a lot of speculation about things have slowed into January, etcetera, and your guidance is obviously indicating that. And I'm just wondering if you feel -- if you can confirm any of the linearity in the quarter, and also just talk about -- perhaps a little bit more about how you control your own destiny, maybe acknowledge share gains or something that gives you confidence -- a little more that gives you confidence on the raising guidance, given the economic backdrop.

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

I'll start. Thanks for the question. Thanks for the comments. I think we saw pretty good linearity at the HP level during the quarter. There was no story in terms of one month being better than the other. So it was pretty smooth. I'll try to give you a little bit more color.

Obviously, we had a good position from a geographic deployment perspective. So when you look across our segments and our businesses, we really had solid growth across all businesses and regions. Again, 69% of our revenues was outside the United States. So again, I think that's probably an asset. Again, in the US, Ben -- and I'm giving you a little more color than your question, but I'll try to give you a little bit more insight -- we've got multiple stories to go on, remembering it's only 31% our revenue -- I say only, but relative to what you see in some other tech peers -- we have an enterprise business that, frankly, we're putting more go-to-market resources in, and there's an effect to a degree of that investment in growth. And frankly, we're putting more effort into the US than we have in the past. So I'm not sure we're the best person to compare specifically year-over-year comps (technical difficulty) because of the effort we're putting into improve our position.

I will tell you in the US, at the end of the quarter, we saw a little bit more caution in the consumer segment than what we have seen in the past. But again, I tell you that in the context of the big picture. On a global basis, we saw pretty steady growth across all of our businesses and segments, and, Ben, clearly stories within the story.

On the EPS raise of guidance for us, part of it, frankly, is the fact that we just have -- the good news is we have a lot of work to go do. The bad news is we have a lot of work to go do. We've just got to get after getting it done. I think as we outlined at the security analyst meeting, we've done a lot of work on corporate overhead; we have a lot of work to do on some of our business unit owned processes, where a lot of our cost is. And as you've heard us say before, we're dead serious about getting this right. And we think getting this right puts us in a very strong position to go out to the market and compete. I can't comment on share gains, because I just don't know all the data yet. I only know, frankly, ours.

Ben Reitzes - *UBS - Analyst*

Thanks a lot.

Cathie Lesjak - *Hewlett-Packard Company - EVP and CFO*

The only thing I would add to that, Ben, is just that we have built capacity in our plans for fiscal '08, so that we can adjust if the demand isn't there that we are expecting. And we really have a good line -- to kind of follow-up on some of Mark's comments -- a good line of sight on our cost cuts. That combined with the investments that we've made to, frankly, improve our position in accounts in terms of the share of wallet, and our recurring revenue, gives us a lot of confidence in our EPS guidance.

Ben Reitzes - *UBS - Analyst*

Thank you very much.

Jim Burns - *Hewlett-Packard Company - VP of Investor Relations*

Let's take the next question.

Operator

Richard Gardner, Citigroup.

Richard Gardner - *Citigroup - Analyst*

Thank you very much. Mark and Cathie, the thing that struck me from a product perspective this quarter was that supplies revenue growth actually accelerated, despite the fact that you had a tougher year-over-year compare. It looked like you were actually a little bit better than seasonal norm for the quarter. I was wondering if you could give us a little bit of color around what is driving the strength in supplies revenue growth, and whether it was toner or ink, etcetera.

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

I know no meaningful difference between toner and ink trends in the quarter. Again, we have the benefit of a large installed base. During the quarter, we shipped our 500 millionth printer. So when you look at this, the pure scale of the business and the size of the installed base, it's a big one. As you know, we've invested from a unit perspective into that base for a while.

Now, let me give you some further color. When you look at the camera and you look at the appliances -- and we were very cautious, as we mentioned in our previous call, about appliance placements, there's -- I'm giving you a full-year characterization here -- roughly 2 to 3 points I'd say of growth headwind -- I want to say it one more time -- growth headwind for IPG in rationalizing those two categories through the portfolio.

So again, I would ask you to take IPG in the context of a pretty radical transformation we're doing inside IPG. We're working on a lot of cost that we're trying to take out of the business. We're investing in growth markets that are giving us substantive growth. To Cathie's point that she mentioned, graphics and the enterprise performed very nicely from a growth perspective for us in the quarter. So we're taking money and investing in those categories, and it is showing up, at the same time as we have a core business where we're sort of picking our spots as to where we feel makes sense to work on.

As Cathie also mentioned, and I'll follow-up on that, that we had some inkjet placements in the quarter that we could have made and didn't, from a unit perspective. We had some tailwind -- some headwind because of the appliances, but we could have done better than we did. And just to be very blunt, I'm not real happy about it. So there's more work for us to yet go do.

Jim Burns - *Hewlett-Packard Company - VP of Investor Relations*

Let's take the next question.

Operator

David Bailey, Goldman Sachs.

David Bailey - *Goldman Sachs - Analyst*

Just to sort of follow-up on that. Your overall per unit growth has come down four quarters in a row. Given the weakness we see in inkjet demand across the industry, should we think of this as a trend that should continue, or are there some reasons that you should start to see some stabilization or a rebound in growth as we go through the year?

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

I'll make a couple of comments and Cathie can follow-up. I sort of tried to give you that even, actually, in Richard's question. We reported 1% unit growth. There's a couple of points of unit growth tied up in the appliance piece. Remember that the laser growth in the quarter was 13%, so very significant double-digit laser growth. So I think when you think a couple of points on the inkjet side of total units would have come back through the appliance side, plus we left a couple of points on the table that we felt we could have had. So you've really got two different tales here. You've got kind of the laser business that's 13% growth that's going pretty quick. You've got the inkjet business that has some of the characteristics you described.

I would, at the risk of giving you one more twist, tell you that long run, we're very focused on pages. So when we talk about inkjet units, we sort of lose the context of what happens in Scitex growth and Indigo growth in the high-end commercial printing that, frankly, has as much to do with our future -- and to Richard's earlier point, we may wind up with a slight disconnect in trying to model unit growth and inkjet to supplies growth, because what happens is the -- and I won't do this again -- but an Indigo printer when it goes up is worth thousands and thousands of inkjet consumer printers going out. And as those businesses grow, you can start to get a disconnect in what the suppliers growth looks like and what the actual inkjet unit growth looks like. And you're going to hear us talking a lot more about trying to get you some transparency to what that page growth looks like, and the implication it has long-term on our supplies business.

Jim Burns - *Hewlett-Packard Company - VP of Investor Relations*

Let's take the next question.

Operator

Toni Sacconaghi, Sanford Bernstein.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Thank you. Mark and Cathie, you're providing guidance for revenues to be down just over 2% sequentially in the second quarter. In four of the last five Q2's, your revenues have actually gone up sequentially in Q2. Given the context for your comments, which seem very positive, is this good old-fashioned conservatism given the environment? Is this something you see coming in the PC marketplace that will cause your PC growth rate to accelerate, which you alluded to? Or is there something else that we should think about relative to recent seasonality?

Cathie Lesjak - *Hewlett-Packard Company - EVP and CFO*

As I mentioned in my script, and we have been saying this now for a number of quarters, we don't think it's a good idea to actually put out -- put a cost structure in place for our PC business and expect it to grow at the same rate it's been growing at. So each of the last few quarters, we have in fact taken our guidance down for the PC side of the house. We also think it's smart from a cost perspective to do that. But other than this, our guidance is frankly very well aligned with the typical seasonality that we see in each of our businesses. The only other thing I would add to this is as our businesses are growing at different rates, the mix in our seasonality is changing a bit. So when you look at it at a total company level, you do need to adjust for that as well. We actually see the seasonality from Q1 to Q2 probably closer to flat to maybe up just a smidge.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

Cathie, are you suggesting then if PCs are a third of your business, and you're about 3 points off your seasonal guidance, that implicit in your outlook is about a 10 point deceleration in the PC revenue growth rate?

Cathie Lesjak - *Hewlett-Packard Company - EVP and CFO*

I don't think it's quite that large, but it's certainly directionally correct. The other thing I would add is that if you look at the seasonal -- the seasonal pattern Q1 to Q2, you've also got to adjust for currency. And on a currency adjusted basis, it's more like 0%.

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

I just can't help myself with the word deceleration, because we're now comparing against big growth rates in last year. So when you combine the growth rate in 2007 with what's going on in 2008, it's -- I saw somebody writing some sort of note about PSG just a few minutes ago that it decelerated to 24% growth for the year, being this Q1 number that we just reported. Boy, if that's a definition of deceleration, it's an interesting comment.

Toni Sacconaghi - *Sanford Bernstein - Analyst*

You'll take it any day.

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

I think to your point -- and we've talked about this before in security analyst meetings -- it's really important for us to not get a business model built on those kind of numbers. Again, what we try to do is build capacity -- to Cathie's earlier point -- into our model, that if that opportunity is available then, and it makes sense for us, we go get it. But the fundamental business model is built on a more conservative platform, and we're not trying to go out and necessarily gain share, and that's the objective. We're trying to build a great business. And if we build a great business, we believe the gain of share and those growth rates are really the result. So I don't know if that helps, but again -- and I know you've heard this before, but that really is our core focus.

Jim Burns - *Hewlett-Packard Company - VP of Investor Relations*

Let's take the next question.

Operator

Bill Shope, JPMorgan.

Bill Shope - *JPMorgan - Analyst*

I was wondering if you could give us some more color on ASP trends, specifically in PCs. They were remarkably tame for you guys, as well as the industry, all of last year. And I'm wondering, are you expecting that to hold this year? Have you seen any material changes in pricing patterns, particularly over the holiday season? And if not, how much room do you think you have here to possibly get more aggressive on pricing to, obviously, gain share, but also to counter some essential macro pressures on units?

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

To your point, it was tame in Q4; it was fairly tame again I'd say in Q1. I wouldn't say that we're seeing pricing pressure beyond the norm. I again go back to the comments of when somebody says did you see a competitive environment; I just don't remember when it wasn't competitive. So if somebody said the other way, did I see some big change, we did not in the quarter. So would we go back to your point to go for more share gains? That's not where we start, Bill. We don't start the discussion with let's drive price as the number-one driver in the market, so it's probably not where we start. Again, we'll look to pick our spots based on markets and segments that make sense, but probably not where we would go. But to answer your question, probably more of what you heard in Q4 than some sort of change.

Bill Shope - *JPMorgan - Analyst*

Thank you.

Jim Burns - *Hewlett-Packard Company - VP of Investor Relations*

Let's take the next question, please.

Operator

Andrew Neff, Bear Stearns.

Andrew Neff - *Bear Stearns - Analyst*

Thanks very much. I just wanted to know, Mark, if you could give us an update on the data center consolidation. There was an article in the Wall Street Journal the other day that quoted you and others talking about how tough it was. Just give a sense of how that's coming together, where you think you are, and what the implications are for HP. And also as you go out to your customers with this sort of -- what you've done for yourself.

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

Thanks for the question. I saw that. We have done -- our team has done just a superb job. We still have more work to do. And as we've talked about, much of the savings that comes along with it sort of trails, certainly, as opposed to leads. But we are a long way through, and it really starts with us with a process change, then an application consolidation and application modernization process, and then that allows us to consolidate infrastructure, and therefore close data centers. So it really falls in that flow. We run the Company -- we started running the Company -- we were running the Company in early 2005 on roughly 6000 applications. Cathie and I looked at this about a week ago; we're running the Company right now on a little more than 3000 applications. So we're about halfway through the application consolidation. We're a little further ahead in the infrastructure consolidation and the data centers that trail it. So that's roughly where we are.

To your point, we've done a lot of hard work. I think the article, which I think was a representation of us telling customers that this is very important work to go do, and what we're trying to do is show all of the things that we encountered as we went through the process, so it becomes a learning vehicle for them. So as a result of trying to teach learnings and to show those, you actually focus on more of the problems than you do the benefits. If I step back for a second and said from where we started, I think our team has really done well, and I think Cathie and I would both say we're awful proud of them.

Andrew Neff - *Bear Stearns - Analyst*

You talked about getting most of it done during fiscal '08. Are you still comfortable with that?

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

I think we're making a lot of progress. We had a very strong quarter in terms of IT getting its work done. It's very important to us, too, because it's not only the fact that we save money, but we also actually get a simpler infrastructure. So just to give you an idea of the implication of this, when you consolidate applications -- I'll give you one example.

We used to have 75 separate consumer support applications at Hewlett-Packard. So we had a separate consumer support application in each country for our consumer PC and consumer printer business. We have now consolidated those to one application, one application that now supports our entire consumer support across the Company, which means IT can now do one modification to our code base, drop it down one time, whereas before we had to do 75 different modifications to be able to get that done. That increases -- not only lowers our cost, but increases our speed, it makes us more nimble, and just gives us a better platform to run the Company. So, yes, I think we're on track. We think we feel good about it. We still have work to do, and we'll let you know as soon as we're comfortable we're at the goal line.

Cathie Lesjak - *Hewlett-Packard Company - EVP and CFO*

And we still fully expect to have a run rate savings for the full-year FY '09 of $1 billion related to IT. And the beauty, frankly, in this model is also that with that reduced spend, you're still getting a much more significant percentage of the spend focused on innovation than you do on maintenance, because with a simpler application and infrastructure, your maintenance costs go down pretty dramatically. And frankly, I can tell you all of our businesses are very excited about getting more innovation.

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

I can't help myself, Andy, other than to say and [the point] that goes to customers that's neat about this is you're actually playing into the environment that says -- listen, in a tough environment, here is an opportunity to get -- to save money at the same time as you get a better platform to go build upon in the future. So the internal work we're doing is in many ways the basis of our enterprise go-to-market discussion with customers.

Andrew Neff - *Bear Stearns - Analyst*

Thank you.

Jim Burns - *Hewlett-Packard Company - VP of Investor Relations*

Let's take the next question, please.

Operator

Shannon Cross, Cross Research.

Shannon Cross - *Cross Research - Analyst*

Just wanted to ask a bit more on the printer side of the business. Mark, when you think about the trade-off between margins and market share and unit placements in that, can you kind of go through your idea on where you're going at for this year, because obviously, with unit volumes slowing, you think you'd have a mix shift to supplies. And I think you also mentioned some pretty aggressive comp moves within IPG. So at the end of the day, how aggressive do you think you'll be on pricing? How much do you think you'll sort of return to the bottom-line through margin expansion, etcetera? Thanks.

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

We'll try to be precise in our aggression, if that makes sense, as opposed to just running around trying to do things that are aggressive in a broader sense. But again, I would like to tell you that IPG is a bit more complicated in the context of think of them with at least four big things we're trying to do at the same time.

One is we're trying to realign our cost structure. And the great thing about IPG is it's a great business that's made a lot of money. The bad thing is it's a great business that's made a lot of money. And like with many businesses that have done that for a long time, we have certain ways of doing things that VJ and Cathie and I know we can do a lot better than we're doing today. And it forms the basis for a big cost opportunity for us, and we're working it.

Secondly, we want to grow the graphics business. Cathie, I thought, was very clear on our [intent] and our performance in that business.

Third, we want to grow our enterprise business. And both of those have performed nicely for us over the past several quarters; again in Q1.

Fourth, there is a core consumer business. We look at that differently by geography. As we described, we look at the laser business a little different than we do the inkjet business. And so when you look at that entire aggregation, we will pick our spots. And I will tell you here that we are not just trying to drive margin; we're looking at the optimization of long-term margin, which has a balance of units of placement, but making sure they're sensible unit placements that have long-term supplies connect at the same time as we try to get short-term operating profit. So it is very possible, Shannon, as you know, that we have a profit number that we wish we would have put more units in the market. And as I mentioned earlier, there were some units we could have put in the market as we looked back on it afterwards that we wish we had. And it is what it is. So we'll go back and make sure we try to get this right as we move forward here.

Shannon Cross - *Cross Research - Analyst*

Thank you.

Jim Burns - *Hewlett-Packard Company - VP of Investor Relations*

Let's take the next question.

Operator

Brian Alexander, Raymond James.

Brian Alexander - *Raymond James - Analyst*

Mark, you were specific earlier in the call saying you'll reduce more costs this year than last year. I guess the question is are you accelerating any of the actions that you've previously announced, in light of the macroenvironment, or has that been the plan coming into the fiscal year? Any change in thinking on reinvestment versus flow-through of those savings in light of the environment? Thanks.

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

No. We're really on the same trajectory. I commented earlier when somebody tells me because of the macroenvironment are you doing something else, it implies there was some inefficiency we weren't going after anyway. And everything in the Company is up for debate. So Cathie and I go through this in excruciating detail to make sure we've got our cost structure headed in the right direction. So I would just tell you we're very focused on getting it right, and we have opportunities to do it. From a reinvestment back in the scale of our sales organization, we are on trajectory to do it, and we're continuing to try to balance the cost takeout relative to the reinvestment.

Jim Burns - *Hewlett-Packard Company - VP of Investor Relations*

Let's take the next question.

Operator

Kathryn Huberty, Morgan Stanley.

Kathryn Huberty - *Morgan Stanley - Analyst*

Thanks. How purposeful was the reduction in inventory in late January? I had the expectation for potentially slower PC growth. Were there any product segments that you feel inventory was constrained at the end of the quarter?

Cathie Lesjak - *Hewlett-Packard Company - EVP and CFO*

It wasn't purposeful, other than to say that we have been working on our inventory management for -- since Q1 last year there has been a real intense focus in the Company on that. And this is just the result of many quarters of hard work. I wouldn't read anything more into it other than much better inventory management.

Operator

Louis Miscioscia, Cowen & Co.

Louis Miscioscia - *Cowen & Co. - Analyst*

Thank you. You had in your press release that you added 2000 more salespeople. Could you give us the total number of salespeople you have? I know you have been talking about for quite a while growing this. Do you think you finally hit the level that you are reasonably happy with? Maybe finally -- and sorry about the multipart question -- you could talk about if a lot of this went into the emerging markets.

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

We don't release headcount information at that level of detail, but we have, obviously, more than 2000 salespeople, since we added them, that many. But I would tell you that we are very undercovered, very underrepresented in the market. And it's an issue for us. We think we have a just superb lineup of products and capabilities. And it's frustrating to us because we, obviously, know we come to work every day and then underdistribute them in the market. We've got a very strong lineup of partners out there. We have 144,000 resellers and partners that help us. But at the end of the day, when you go through a detailed market mapping by market segment, by geography, by product segment, even by industry where it makes sense, certainly in the context of the mid-market and the enterprise, we are dramatically undercovered. And when I say that, it's -- we're not off by 10% or 20%; we're off by more than that. So we're trying hard to beef it up. And it's not all direct salespeople, so we give you that number as one factoid. But it really is a combination of partners, sort of badged and full-time employed HP people, working in unison to try to get a broader distribution footprint across the entire market.

Much of it is in emerging markets, but it's not all in emerging markets. As you've heard, 31% of our revenue in the US, and the US is one of the markets that we're not as well-distributed as we would like to be. So it's a -- it's a broad-based issue for us, just as our cost issue is a broad-based issue for us. We try hard to work them in alignment, and this is the issue for us, to try and do two things at the same time. And that's what we're working on. So we have improved the situation based on the headcount that we described, and also relationships and investments we've made in the channel. That said, there is more work for us to go do.

Louis Miscioscia - *Cowen & Co. - Analyst*

Thank you.

Operator

Scott Craig, Banc of America.

Scott Craig - *Banc of America - Analyst*

Cathie, can you maybe talk about the cost -- the component cost environment a little bit? You mentioned that you don't see it as being as favorable going forward, so can you be a little bit more specific? It just seems like every quarter we keep hearing that. And the component pricing doesn't look that bad to us; actually, it looks like it's gotten a little bit better over the past couple of months. So any flavor there would be appreciated. Thanks.

Cathie Lesjak - *Hewlett-Packard Company - EVP and CFO*

In Q1 it was, clearly, more favorable than we had expected. And you saw that in the margin expansion at the HP Co. level, as well as the operating margin expansion at the PSG and enterprise server and storage level. In terms of an outlook, we think that the supply generally looks good. We are starting to see kind of a memory pricing environment that seems to be stabilizing a bit, or getting more solid. There could be an uptick there, but we're certainly not seeing the same sort of declines that we've seen in the last couple of quarters. So we're basically pricing in, or thinking about, the fact that memory will be a bit tougher than it was in the last couple of quarters, and factoring that into our guidance.

Scott Craig - *Banc of America - Analyst*

So it's predominantly memory then? The rest you still see as being somewhat favorable then?

Cathie Lesjak - *Hewlett-Packard Company - EVP and CFO*

I think LCD panels as well have started to tick up a bit. Memory is the biggest delta if you think about it from kind of quarter-to-quarter, in Q4 and Q1. But you definitely have seen some firming in prices in LCD panels as well.

Scott Craig - *Banc of America - Analyst*

Thank you.

Operator

[Jason Nolan], Robert W. Baird.

Jason Nolan - *Robert W. Baird - Analyst*

A question on -- a follow-up earlier to the data center question. Are you still seeing demand for tours of your new data centers in Texas? And specifically, are enterprises more likely to undertake a large data center consolidation in this environment?

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

First of all, we have -- I think I can actually say this. We have runaway demand for people that want to get into our IT organization and understand what they have done. We try very hard to not do just a one-off event with IT folks. We try to consolidate them and make them more formal, and give people more exposure to what we've done in IT, because we have an IT organization that still has work to do for Hewlett-Packard. So, yes; we have very strong demand for people to see it and people to get into our data centers. But frankly, not just get into the data center, but understand strategically what was done, and then how the execution was done. And most of our work is done to create sort of playbooks that actually talk about the way we approach things and, to be very blunt, as I think Andy talked about earlier, the mistakes that we made, where we made them, in terms of our approach.

In terms of companies, I think there are different companies in different forms of maturation in terms of the states that they're in, and that has an implication on what they do. But there is no question right now there is a lot of attention [to] IT, and a lot of attention in terms of the relationship of IT to business benefits. So we think it's a major opportunity in the market, and there is a lot of strategic dialogue -- I'll put it that way -- about how people think about IT and the approaches they take to rationalizing it.

Jim Burns - *Hewlett-Packard Company - VP of Investor Relations*

Let's take one more question please, operator.

Operator

David Wong, Wachovia.

David Wong - *Wachovia - Analyst*

Thank you very much. Can you give us the unit growth on your industry standard servers, and also the absolute level of channel inventory? I think you gave us year-over-year, but not the absolute level of channel inventory.

Mark Hurd - *Hewlett-Packard Company - Chairman, President, and CEO*

I think unit growth -- I just want to make sure. I know the number. I'm trying to -- do we give this out? It was very high double-digits. I'll just leave it at that. High-teens. High-teens. The high-teens was unit growth in ISS, and I'll leave it at that one.

We typically don't give the absolute channel inventory numbers. As we give them out, we give them in terms of weeks, and we give them in terms of compares. So that's (inaudible) the ESS inventory, which is what we report, was healthy and very well-positioned coming out of Q1. And that was again purposeful on our part to just position ourselves well going into the rest of the year.

Okay. Thanks for your questions. I'd like to summarize today's call by saying that HP had a strong quarter. It was characterized by balanced growth across all regions, share gains in key businesses, margin expansion, expense discipline, strong cash flow from operations, and significant share repurchases. Going forward, I'm confident in our ability to deliver strong results based on the three elements I mentioned to you earlier -- significant cost savings that both fund our growth and expand earnings; our deployment of additional sales resources to capture incremental opportunities in the enterprise and mid-markets; and third, a diverse global customer base and a broad product portfolio that is aligned with the growth areas in the market. Given the solid fundamentals within our business, we are increasing our non-GAAP EPS guidance for the 10th consecutive quarter. I'm pleased with our progress today. We have a lot of work to do, and I'm confident that we can continue to produce another year of strong financial returns. Thanks again for joining our call.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. That does conclude the presentation. You may disconnect. Have a wonderful day.