

FINAL TRANSCRIPT

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HPQ - Hewlett-Packard at Bank of America Securities Annual Investment Conference Breakout Session

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CORPORATE PARTICIPANTS

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Hewlett-Packard - IR

Cathie Lesjak

Hewlett-Packard - EVP & CFO

CONFERENCE CALL PARTICIPANTS

Scott Craig

Banc of America Securities - Analyst

PRESENTATION

Scott Craig - *Banc of America Securities - Analyst*

I'm Scott Craig. I cover the IT hardware space here at Bank of America. We are pleased to have Hewlett-Packard with us here. Obviously a lot going on in the name recently. To my far, far right is Cathie Lesjak, the CFO, and to my immediate right here is Jim Burns from Investor Relations.

I'm going to turn it over to Q&A in a second here. First I have to read a public appearance statement, and then we will get right into the Q&A. As you are aware, we are required to make a number of conflict of interest and related disclosures in connection with our participation in this conference and the companies that we may discuss. If you would like to review these important disclosures, please pick up the packets containing the public appearance disclosures at the back of this room. PDF copies can be accessed by those of you viewing these presentations via webcast.

Jim Burns - *Hewlett-Packard - IR*

Just from HP's standpoint, we showed our forward-looking statement. It's out on our website to so in the event we make forward-looking comments all the disclaimers are on HP's IR website. Thank you.

Cathie Lesjak - *Hewlett-Packard - EVP & CFO*

And we expect you all to login and check them out.

Scott Craig - *Banc of America Securities - Analyst*

With that, we will open it up and hopefully we get some questions.

QUESTIONS AND ANSWERS

Unidentified Audience Member

In your presentation, you mentioned that you thought you had gained shares in printers. I was wondering if you could just give a little more detail on where the share was coming from and who you might be taking it from.

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Cathie Lesjak - *Hewlett-Packard - EVP & CFO*

If you look at calendar Q2, we gained roughly a point of share and that came predominantly from -- well, it came exclusively from inkjet printers. So inkjet printer share was up about -- a little over two points, almost three points. Then on the laser side we lost about a point of share. And that we lost share predominantly in the low end, and we lost that share to Samsung was probably the one I would call out the most.

They have been very aggressive in pricing of the low end to the extent that it really doesn't give us the right usage model longer-term and cannot get the return that makes sense for us. So you will see us do that where the markets don't make sense we are not going to go after units. We have a very clear idea of what it takes, what kind of usage you need in order to generate a positive return.

Scott Craig - *Banc of America Securities - Analyst*

Cathie, can you expand a little bit on the IPG group? I asked the question in the last meeting, and this one is webcast also so I just want to make sure that people get it. Clearly, that has been a very profitable, cash flow positive segment for your business over the last few years and arguably held you guys up when other areas were doing poorly.

Now it seems that you are going to start focusing on that area, which is a little bit of a change of gears probably. So take us through where you think the biggest opportunities are from an IPG standpoint from a cost perspective.

Cathie Lesjak - *Hewlett-Packard - EVP & CFO*

The biggest opportunities for IPG outside of the corporate shared service kind of initiatives that are going on, which by the way we are going to be taking out more costs in '09 than we took out in '08 and we doubled -- in '08 we doubled the cost savings than we did in '07 -- so there is still a lot of benefit to all of our segments of that but as well for IPG.

The very specific IPG initiatives are both -- there is some around OpEx, although that is not the biggest impact. There is opportunity there in the RAD space, and this isn't about reducing R&D. This is about making sure that all the science projects are cut off in the IPG R&D, and putting all of our R&D dollars behind the projects that we want to continue to invest in.

So there is some clean up there, but that is not where there is a lot of cost savings. There is a lot of productivity and effectiveness savings there. The real cost savings are going to come in cost of goods sold, and it's really around streamlining and optimizing the supply chain.

If you think about SKU reduction, as an example, to the extent that we can get down to a lot less SKUs, which we believe we can. There is just a lot of savings in terms of the whole supply chain, the testing, the quality assurance around the products, the amount of inventory that you need to have both on an HP level as well as in a channel. And so there is opportunities there that will give us some real good savings in IPG.

Scott Craig - *Banc of America Securities - Analyst*

How long do you think it takes to get IPG to where you want it from a new profitability perspective? Is it a three-year process or five years? How do you think about timing?

Cathie Lesjak - *Hewlett-Packard - EVP & CFO*

Timing is two to three years, and we are about a year, six, nine months into it. And I mentioned in the previous webcast meeting that we are roughly -- in '08 we expect to get roughly 20% of the savings of all of the initiatives.

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Scott Craig - Banc of America Securities - Analyst

Okay. Do we have any questions?

Unidentified Audience Member

I guess I just wanted to switch gears and talk a little bit about PC growth. You guys are in a period where you have pretty tough comps on a year-over-year basis. You have been outgrowing the market pretty impressively over the course of last year. We have seen negative comments from Dell, from [Ingrin Micro] on the market in the US and in Europe.

I guess it's multi-part. If you can just talk about whether or not you think you have the offsets from a mix perspective to hedge or offset some of the maybe slowing growth in the US and Europe. Then, secondly, how you think, if there was a pretty significant slowdown, and we are on tough comps, how you think the impact would be from a margin perspective and whether you would feel as though you have those offsets to keep margins within the targeted range.

Cathie Lesjak - Hewlett-Packard - EVP & CFO

I have to tell you when folks look at Q3 15% revenue growth in PCs and get upset that things are slowing down. It's pretty darn good numbers there and we are very pleased with that kind of revenue performance, especially on top of very tough comps. So if you go back to Q3 last year we grew PC revenue 29%. We are coming up on a tough comp in Q4 on a 30%, but still outgrowing the market and are very pleased with the growth that we are getting in PCs.

If revenue growth were to significantly come down, it's not a huge concern for us because a large part of our PC cost structure is variable. So it just kind of all adjusts. And if -- even the pieces that we are not calling variable adjust over less than six months. So there is a big chunk that adjusts very quickly and then there is a chunk that takes a couple of quarters, just under a couple of quarters to adjust. So if it were to significantly move, it still wouldn't be that painful for HP from a profitability perspective.

But then to go back and really look at what are the market dynamics and what is driving the growth in PCs and how do we stack up in that space, we still see notebooks, emerging markets, and even the consumer, especially in the emerging markets, as been the drivers of growth. Those are our sweet spots. They have been our sweet spots for the last couple of years. It's why we have been able to outgrow the market so significantly over that time frame is because we are in the right places at the right times with the right products.

If you look at notebooks specifically, it's hard to see that that shift from desktops to notebooks is significantly going to slow. Our data shows that roughly only 40% have converted from desktops to notebooks. And that shift is huge for us because you get the white box in the desktops, you go to notebooks and we compete for that kind of share.

The white box in notebooks is tiny and so as people convert, we actually have a real opportunity to gain share and we have been. We think that that secular change is still going to continue and it's really what is driving the bulk of the PC growth.

Jim Burns - Hewlett-Packard - IR

Additionally, notebooks tend to get replaced more frequently than desktops, too. And that is another good guide from a market standpoint, the fact that business is moving that way and that the replacement cycle happens quicker, too.

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Unidentified Audience Member

Right, and get a little bit shorter on the mix. Then I guess one of the big trends in PCs is the shift to these really low end ultra-portable, the low-end scaled-down versions of these notebooks. Can you talk a little bit about margin impact that you see and maybe what you see from a mix perspective maybe over the next couple of years?

Cathie Lesjak - Hewlett-Packard - EVP & CFO

Our product in that space we actually I think it's -- the number is 2133 and it's called a Mini-Note. It's really -- today it's really targeted at the education market and doing really well. It has certainly done better than what we had anticipated, so that is the good news. The bad news is, of course, we had to -- we didn't have the production that we wanted initially and we are really ramping that up. But there is a real opportunity.

What is interesting about that Mini-Note is there is an opportunity to take it up to actually get to a more highly configured notebook, Mini-Note. The kind that you and I when we are going to go on a trip want to throw in our briefcase because we don't want to have as big a footprint as we have got today and what we need is e-mail and surfing the net. This is a perfect product for that so it will be a -- we believe it will be a second PC for at the higher end. Then there is an opportunity to take it even lower, as well.

From a margin perspective, we get good margins on this product. We have built it with cost, obviously, very much in mind and so we are not overly concerned about that becoming a bigger part. We don't actually think it cannibalizes a lot at the margin. It might cannibalize some, but again you are looking at the high-end second notebook that folks will carry when they travel and then the very low end as an opportunity, as well.

Jim Burns - Hewlett-Packard - IR

We are initially targeting, also, at the education market where we are pretty under penetrating. When you think of people moving from three desktops in the back of the classroom to having an affordable solution so you can outfit the whole class it's an interesting opportunity for us as well as the emerging market opportunity.

Scott Craig - Banc of America Securities - Analyst

Cathie, from an IPG perspective, if you step back years ago you used to be able to watch units and eventually supplies would kind of mirror that over time. It seems like there is a pretty big disconnect going on there right now between the unit growth and the supplies growth. Is that something that continues? And how do you keep the supplies growth going at the rate it is with the units being a little bit underwhelming, to be quite frank?

Cathie Lesjak - Hewlett-Packard - EVP & CFO

You really need to look at what is driving the units. There is a number of different things that are going on in terms of unit growth. One of them is our push in graphic arts. So one unit, one indigo unit, depending on how highly configured it is, can drive anywhere from 10,000 to 20,000 -- replace 10,000 to 20,000 inkjet units. So as you get more of those units yes, it dampens unit growth. But there is a lot of supplies that come from an indigo printer and we love that mass. So that is one impact.

But the other impact that actually is going to drive a bigger disconnect in my mind from our installed base is if the installed base continues to hold their peak printers a longer. Because if they hold them longer but they don't significantly change the amount that they print, the supplies growth will continue. Units won't. And units have a drag on operating margins. Obviously, supplies don't. So that is very positive long-term for margins.

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Then also in the previous session I talked about the fact that folks are moving more and more to wireless. Our unit growth in wireless was in triple digits. We are the market leader in wireless printers. And as more and more households move to wireless printers and don't change the amount they print, again, replacing one unit instead of anywhere from two to three units per household. So there is, again, a nice uptick on the supplies profitability relative to the investment that you have to make on printers.

All of those things of course, dampen printer unit growth. All that being said, let me tell you that the 11% in supplies growth that we did in Q3 we think is unusually high. We think over the long term we are really talking about sustainable mid to high single-digit supplies growth. Again, there will be quarters that you will do better than that and there will be quarters you do worse, but over the long term that is what we believe is sustainable, kind of the growth that we are expecting.

Unidentified Audience Member

Cathie, as long as we are talking about printers, can you talk about the momentum with Edgeline and whether the EDS acquisition helps you get unit placements may be in management environments?

Cathie Lesjak - *Hewlett-Packard - EVP & CFO*

I think the EDS acquisition is helping us with managed print services, which obviously is an important part of continuing to grow on the Edgeline side, and so I do think that that is a tremendous opportunity. We probably have some other product things that we need to fill out, and so we are working with EDS to kind of put together the total HP offering around managed print services.

Unidentified Audience Member

Just in terms of Edgeline in general versus your expectations at this point?

Cathie Lesjak - *Hewlett-Packard - EVP & CFO*

It's ramping. It's not ramping as quickly as we had anticipated, but it's getting good market acceptance. It's just a longer sales cycle and a different sales cycle. Since when you are really talking in the copier market, you are talking about a different set of channel partners.

We are working on building out those channel partners and that is kind of a big reason why it's not ramping as quickly as we had expected. But the customer acceptance has been very positive. Lots of good excitement about the product.

Scott Craig - *Banc of America Securities - Analyst*

It's always difficult to relate Asian production to what you guys are seeing from a growth perspective, but there has clearly been some negativity around Asia recently at the ODMs from a desktop and notebook perspective. They are seeing cuts across the board and, clearly, you guys are a big partner with those guys.

So how do you think about the production side of things versus what you are seeing from a growth perspective? And maybe relate that regionally how you are thinking about PC growth from the US, Europe, and Asian perspective.

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Cathie Lesjak - *Hewlett-Packard - EVP & CFO*

A year ago at this conference --

Scott Craig - *Banc of America Securities - Analyst*

I remember that.

Cathie Lesjak - *Hewlett-Packard - EVP & CFO*

I made a specific comment because of the rumors flying around that Asian production, things were getting cut, specifically HP. It was a big cloud over the market, to be honest with you, beyond just HP. The comment I made at that time was really around the fact that you can't look at it. You can't go in and say, okay, HP canceled orders here because you don't know the whole picture and it is very complicated. And I will stick to that.

At the end of the day that is how we are managing the production side to make sure that we get the product that we need for the demand that we are generating. I can't -- I'm not really going to comment on the current quarter, but it's really a dangerous thing to focus on what is going on unless you go to every single supplier and every single supplier were to tell you HP is canceling orders. We are managing it real time all the time throughout the quarter.

Scott Craig - *Banc of America Securities - Analyst*

And then from a growth perspective, from a PC basis, how do you think about it regionally? Are you seeing any changes from an Asian perspective where growth has been actually pretty darn good? Are we seeing any changes there? Can you talk about Europe and the US, as well?

Cathie Lesjak - *Hewlett-Packard - EVP & CFO*

If you go back to our Q3 results, I would tell you we are not seeing a whole lot of significant changes from a demand perspective. There may be the mix within a region from a country perspective, it's a little bit different. The biggest impact is the tough compare. That is the biggest impact. When China slows from 90% growth to 50% growth, it's slowed. Fact. 50% growth? Go have got it. I like it.

So you just -- you have to make sure you keep your perspective clear because at 15% revenue growth in Q3 we are very pleased with it. We don't need that kind of growth to continue to generate very solid margins in PCs. We don't need even a 10% or 11% growth at the total company level to generate significant margin expansion.

So yes, we love the growth, but we are looking for profitable growth. We are not going to go out and do growth for growth's sake. So that is a huge piece of our strategy is to focus on that.

Unidentified Audience Member

Could you discuss the internal developments or perhaps outside partners you might be working with for mobile external power? For various devices?

Cathie Lesjak - *Hewlett-Packard - EVP & CFO*

I'm going to let Jim handle that one.

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Jim Burns - *Hewlett-Packard - IR*

Mobile external power.

Unidentified Audience Member

Yes, being able to recharge your devices without a plug in the wall.

Jim Burns - *Hewlett-Packard - IR*

Yes, we do work with different providers, and we -- obviously, there is a lot of quality control that goes into that, too, just given the importance of running electricity through the devices too. I don't think we have any single suppliers we want to call out or talk to. I think, certainly getting the right form factor to be able to charge a device quickly but also be able to provide options for people that want lighter weight devices.

But I think when we look at people, at suppliers for that area, we are predominately, first of all, making sure we are focused on product quality just so we don't have any safety issues etc., there too. But we continue to look at that. I'm not sure if you have any --

Unidentified Audience Member

Yes, but how close are you to having external mobile power for your products?

Jim Burns - *Hewlett-Packard - IR*

External mobile power.

Unidentified Audience Member

Being able to recharge on the run.

Jim Burns - *Hewlett-Packard - IR*

Recharge on the run, I --

Unidentified Audience Member

You don't?

Jim Burns - *Hewlett-Packard - IR*

I don't believe we have a solution today. We typically for these things to start off with third-party solution providers we will qualify them. So typically anytime you get a new accessory, a new technology rather than -- because it's not pervasive you don't build it into the product and try to ship it there because it adds cost to the machine.

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So what you do is you partner with providers, you qualify them, you put them on a tested list saying these things work with our products. They are safe to work with our product and sometimes next day you may do some bundled devices before you end up kind of putting them in all your products.

We are doing that with the 3G wireless cards right now, too. Rather than putting -- building in integrated WAN into the devices, which costs money, we will partner with different folks. So I think you will see us go the same direction --

Unidentified Audience Member

How long do you think one of these partnerships will develop so that you actually have a product? I'm just curious. That is all.

Jim Burns - Hewlett-Packard - IR

How quickly will become pervasive in terms of built in to the product?

Unidentified Audience Member

No, not built in. Just so the people who aren't close to a plug will be able to recharge their various devices.

Jim Burns - Hewlett-Packard - IR

I think that will just depend really on how the industry develops. But to the extent that there is guys that are out there that have quality products that we feel comfortable that aren't going to do anything to our products, so I guess I don't have anything more to add in terms of timing for it. But we will -- as soon as you get branded players out there with availability and product quality there you will see us be there with the market.

Unidentified Audience Member

I was just wondering if you could comment for a minute on how virtualization is impacting you guys, specifically do you see maybe in the medium to long run impacting server growth unit sales negatively, I would assume? Or maybe on the other side of the coin do you see it driving demand for network storage products? Has that been reflected in your business at all yet?

Cathie Lesjak - Hewlett-Packard - EVP & CFO

We think of virtualization as being very good for Hewlett-Packard. So we are not -- we are looking at virtualization as a market disruptor that allows us to compete more broadly for a larger share of the market, so very bullish on virtualization. We are building products that take advantage of the opportunity.

So when the you think about our blades, which grew 58% in Q3, we have over 50% market share. Our blades are virtualized twice as much as other products. So we are really focused on helping to drive the virtualization because we think it's very good for CIOs and IT budgets and good for Hewlett-Packard. And that is around servers, storage, the opportunity to go after some of the mainframe market as folks decide that they don't need to be on the mainframe anymore around the margin and they want to virtualize.

We also -- it's really important, we did a survey and, if I remember the stats right, something like 89% or 90% of the CIOs said that they expected only a roughly 25% of their data centers to be virtualized by 2010. That says this thing is not moving at light

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speed. It's moving over time, which means as it virtualizes -- by the time we get far enough along in the virtualization that you might see a slowdown in servers--

At the end of the day what I think we are going to see is we are going to start seeing the early adopters refresh and so you are not going to see this massive slowdown in the server units. But to some extent, there will be it. The servers that you are now selling are much richer configurations and so a lot of opportunity in that space, as well.

Unidentified Audience Member

Ultimately, do you see the installed base of servers either slowing or maybe even eventually decreasing? Or do you think that maybe the expanded power and pricing will make up for any difference there?

Cathie Lesjak - Hewlett-Packard - EVP & CFO

I think there is that piece of it that will help make up for it and the fact that the demands on the infrastructure to do more will mean that people will continue to build out their data centers. At the end of the day with the amount of content that is coming at folks that they have got to manage and store and have people access is huge. And that is going to continue to come at them.

A CIOs challenge that the CEO is giving them is that I'm not going to increase your budget that much, so you have got to figure out how to do it. Now I'm cheaper and faster. And part of that is around the infrastructure but a big piece of it is around Telcom and the amount of time that you spend on people cost around maintaining the data center.

Scott Craig - Banc of America Securities - Analyst

I think we are out of time. Thanks a lot Cathie and Jim for participating.

Cathie Lesjak - Hewlett-Packard - EVP & CFO

Thank you.

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