

# FINAL TRANSCRIPT

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## **HPQ - Hewlett-Packard at Bank of America Securities Annual Investment Conference**

**Event Date/Time: Sep. 16. 2008 / 1:00PM ET**

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## CORPORATE PARTICIPANTS

**Cathie Lesjak**

*Hewlett-Packard - EVP & CFO*

## CONFERENCE CALL PARTICIPANTS

**Scott Craig**

*Banc of America Securities - Analyst*

## PRESENTATION

**Scott Craig** - *Banc of America Securities - Analyst*

(Audio in Progress) -- Scott Craig. For those of you who don't know me, I cover the IT hardware space here at Bank of America. We are pleased to have a Hewlett-Packard with us and Cathie Lesjak here on my immediate right, CFO of Hewlett-Packard. First, before we get started here -- we're just going to go right into Q&A but I have to read a public appearance statement.

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 the room and at each of the breakout sessions. PDF copies can be accessed by those of you viewing these presentations via webcast.

So without further ado, we will just head straight into Q&A. And I guess Kathy on the top of everyone's mind --

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

Can I interrupt you?

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**Scott Craig** - *Banc of America Securities - Analyst*

Sure.

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

You have read your public statement. I just need to point out my public statement which is on the screen here around forward-looking statements.

## QUESTIONS AND ANSWERS

**Scott Craig** - *Banc of America Securities - Analyst*

All right, so let's just take it off with EDS. You guys had, obviously, a very positive announcement yesterday. You probably surprised people on the upside as far as the accretion question goes, so just kind of outline your thoughts on how that rolls out over the next couple of years from a timing perspective.

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

At that conference yesterday, I don't know if people are aware, but what we announced was that on a long-term basis we see the savings opportunity to be roughly \$1.8 billion on an annual run rate basis. And this is after we reinvest some of the headcount savings in replacing headcount as well as reinvesting some of that savings in both repricing of deals, being more competitive across a broad range of deals, as well as adding additional sales reps.

So if you think about that \$1.8 billion, that is kind of run rate longer-term. We didn't put a specific time frame on there, but it's not in the first two to three years but it's not horribly long term either. The progression to get there is that in fiscal '09 we will get roughly \$500 million of those savings and in fiscal '10 we will get roughly \$1.3 billion. So making good progress there.

If you take it and look at it more holistically and look at the EPS impact to HP, in Q4 '08 the EDS impact is \$0.01 dilutive to neutral. And that is really as a result of the additional cost of debt as well as the deferred revenue write offs that you have to take early -- relatively early on in the deal as well as some of the impacts of the accounting convergence as we bring EDS onto the same policies that HP uses.

Then in fiscal '09 \$0.18 to \$0.22 accretive to what we would think -- have you guys think about at the pre-EDS HP financial models. And then finally in what we have out there in '10 is accretion of \$0.38 to \$0.42. Again, additive to your pre-EDS HP financial models. So we are feeling very positive about this transaction.

I think we felt that way from the beginning and we are slowly but surely getting you all aligned. And that is why yesterday was such an important day for us because it finally allowed us to fully tell our story and help you all understand what the real benefits are of the EDS acquisition.

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**Scott Craig** - *Banc of America Securities - Analyst*

Cathie, normally you guys are relatively conservative. You seem to beat numbers almost on the -- pretty much every quarter, so do you feel you are being conservative from the EDS standpoint? Can we see upside to that and where would that upside come to from if it does happen?

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

At a basic level you really can't change your feathers so, yes, by definition we are conservative. You definitely will see that in this and just about everything that we put out there. We want to make sure that we have got plans that align and we can deliver what we promised. And that sometimes obviously over deliver.

In this particular case, I think that is true. I also think there is risks that cause us to maybe even be a little bit more cautious, just because this is a big company. We have made a lot of progress and we feel very good about the work that we have done from a planning perspective, but now we are kicking into execution. Again, great plans; have a playbook around a lot of these savings opportunities that we have got because we have done it at the HP level. But nonetheless we are bringing on a lot of new employees and making a lot of changes.

I am sure you noticed that we have got headcount reductions of roughly 24,600 over three years, so there is a lot of moving parts. And that obviously puts us -- makes us want to be a little bit more conservative maybe even than normal.

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**Scott Craig** - Banc of America Securities - Analyst

Okay. Then with regards to Dell this morning, they obviously had a announcement. Maybe you can talk a little bit around that. They say they are seeing further weakness. Can you comment on that? Not that I want to bring in a competitor question, but somebody is going to ask it so I might as well.

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

So you also know that we don't comment on the current quarter. I think that the best way to answer that question and I am sure I will get it asked a number of different ways throughout today, but the best way to answer it is that at our analyst meeting yesterday for Q4 '08 while we said there was still, with the strength of the dollar, downward pressure on revenue that we still were very confident in the EPS guidance that we provided at our August 19 call. I think that is the best way to answer the question.

**Scott Craig** - Banc of America Securities - Analyst

Okay. With that we will open it up for some questions from the audience.

**Scott Craig** - Banc of America Securities - Analyst

Anyone?

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

Wow, no questions. We must have been really good yesterday.

**Scott Craig** - Banc of America Securities - Analyst

Cathie, from DDS standpoint, from a business continuity perspective, obviously the layoffs are fairly sizable. How do you get comfortable from a continuity perspective with the customers, even going to best shoring or whatever you want to call it? And then from that perspective from a comfort, how much of the cost savings do you think you have to give back to the customers as --? They are going to realize that you are doing some cost cutting and want to participate in the savings.

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

In terms of where we are targeting the early cuts, it's really in the folks that support the front-line folks with respect to customers. The impact on the customer facing folks is relatively minor. I characterize it as the impact is where there is complete overlap or underutilization, and as a result don't really expect to be significantly impacting customer facing folks or the customers directly. And that gives us, obviously, a lot of confidence and is a real objective of ours to make sure that we continue to deliver high levels of customer service.

In terms of the pressure on margins, because we are moving to lower-cost locations then we do expect customers to put some pressure on us giving some of that back to them. We factored that into our analysis and have captured what we think will happen with a bit of a hedge, to be honest, in the accretion numbers that I provided earlier.

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**Scott Craig** - Banc of America Securities - Analyst

Just switching gears a little bit, when you look at the IPG group it has been a focus for investors from the standpoint where pricing seems to have been a little more aggressive and the unit growth wasn't quite what people were expecting. Can you take us through what is going on in the IPG group and how you look at that longer term, both from a revenue and from a profitability standpoint?

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

There are just a lot of ways I can go with that one. So let's start with the fact that it was a very tough and is a very tough market in the printing business right now. We believe that in Q3 that though it was difficult and we did have lower unit growth, negative unit growth then what we had been putting up, especially in the laser space, that we did gain share. So overall we gained roughly a point of share in calendar Q2 from a printer perspective.

But what we are seeing, which is actually long-term positive for profits, is that we are seeing folks hold onto printers longer. And because printers are just an investment, you basically place them into the market at a very low gross margin or at a negative gross margin when you think about ink units, that it's actually good for customers to hold their printers longer as long as you have a healthy installed base that is continuing to print.

One of the metrics that we use to gauge whether or not folks are continuing to print is cut sheet paper growth. The cut sheet paper growth has been -- it hasn't been robust, but it hasn't significantly changed either. So that says to us that our installed base is a healthy installed base and still printing.

One of the other things that is very, very positive long-term for profits in IPG is really the move to wireless printers in the home. I don't know about you but today in my home, and I live in California so I have a very small home, I have got three printers because my kids don't want to have to keep shifting USB cords. They want to be connected all the time, so the move to wireless printers in the home is huge for Hewlett-Packard.

So if you take one wireless printer and it replaces three wired printers but you print the same amount, it's great for profits, right, long-term because we don't have to place as many units. That, of course, is going to dampen the unit placement growth but still be good for profits.

Then the final point around unit placements that is important to get through as well is we are growing significantly in the graphic arts space. When you place an indigo printer it's one unit, but it's the equivalent, depending on the configuration and the size of the indigo printer, of 10,000 to 20,000 consumer inkjet printers. And so that has a dampening effect on printer growth as well.

**Scott Craig** - Banc of America Securities - Analyst

We have a question up here, up front.

**Unidentified Audience Member**

How much does the rising dollar impact your growth?

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

The way we have articulated it is that there is a material impact on revenue depending on how strong the dollar is, so there is no question that if you look at the top dollar growth rate it's going to be dampened by the strength of the dollar. If you actually

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look at local currency growth though or constant currency growth, which is really what we focus on, that should be relatively stable.

And at the end of the day what is, I guess from my perspective most important, I would think from yours as well, is what is the impact on profits. When we look at it over a long period of time, you have to think about the different segments within HP for sure because PCs, when the dollar strengthens or the dollar weakens pricing reacts very quickly. And therefore the impact to profit is not significant and there isn't even a big timing difference.

If you look at printers and industry-standard servers, they are all kind of that end of the continuum. If you look at UNIX or business critical servers, they are at the other end of the spectrum. They don't reprice as quickly and therefore it's more of a two to three quarter lag before you are going to see the repricing take place. And therefore, they will have an impact on profit. Not a very big piece of our business.

If you look at services there is a piece that doesn't reprice very quickly and therefore we hedge longer, and then there is a piece that actually comes off from deferred revenue. When a customer buys a support package of three years and pays for it upfront, it gets booked to the balance sheet and then amortized into the P&L over time. And that comes in at whatever rate that you booked it at.

So all of the contracts that we have booked over the last couple of quarters, anywhere from a EUR1.45 to a EUR1.50 are going to come through the P&L over the next couple of years at that rate. And so that gives us obviously a buffer there as well. So if you take all of these pieces, mix them all up with what we expect the mix to be, we really view the impact on profit to be marginal at best. No significant gain from a weak dollar and no significant hit as a result of the stronger dollar.

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**Scott Craig** - Banc of America Securities - Analyst

Any other questions from the audience? Cathie, can you talk about the operating profit in the PC business? Your target has typically been, let's call it like 5% to 5.5% roughly. Clearly, you have had some component costs help over the last couple of years, let's call it. How do you view the components cost helping or hurting the business going forward? Then what are some of the other levers that you guys can pull in that division to maintain your targeted growth, targeted margin rate?

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

The way I view the benefit of the component price environment, and it changed significantly last quarter, so let's be clear that it became a much more normalized commodity pricing environment. Because it's not just about what the price is that we have to pay for the commodities, it's how much gets priced away if there is a reduction in the street price.

The way I really view it is that that benign commodity price environment accelerated us getting to a position of 5% to 5.5% or if you actually look at Q3, at 5.7%. What was always going to get us to the 5% to 5.5% was not an assumption around a benign commodity pricing environment, but in fact the cost initiatives that we have been undertaking.

So this really just allowed us to get to the spot we were going to get to faster, but in a -- that is a more temporal situation. The fact of the matter is if you go back to our security analyst meeting in December the 5% to 5.5% for '09, confident that we can get there because we have done the cost cutting even as the commodity pricing environment becomes more normalized.

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**Scott Craig** - Banc of America Securities - Analyst

Then can you talk a little bit about, let's talk about core HP. Because one of the arguments from the bears if there was an argument was that you are doing EDS so you have finished the cost-cutting side. You have finished the efficiency side on the core HP

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business. But clearly, to us that doesn't seem to be the case. But can you discuss where the cost opportunities are? How far along we are in the game from a core HP business perspective?

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

So let me go on record as saying that the bears are just wrong. There is no reason why HP can't focus on getting its core HP right from a cost perspective and do EDS at the same time. So let's talk about the core HP cost initiatives.

We have got a number of different initiatives. The ones that we talk about the most are in what we call the shared services area, so that is HR, real estate, IT, finance, legal. We have been executing on the plans that we have been talking about and we continue to execute on them. In terms of the really big ones, IT is the largest and we are on target to hit a full year's run rate savings of \$1 billion in fiscal '09.

If you look at -- we have gone from 85 -- what we call 85 large data centers down to three pairs, that is our goal. We expect to exit Q4 with one or two left over from that 85, so making great progress there. Our applications, we have cut our applications down significantly. We have gone from roughly 6,000 applications that run the Company down to, right now under 2,000.

That is significantly simplifies the architecture both from a hardware perspective, when you get down to the number of data centers we are getting to and the number of applications, and just allows us to significantly up innovation and reduce maintenance. So we are completely flipping that.

So we were spending something like 75%, 80% of our dollars on maintenance and the rest on innovation. Now we are spending it going into '09 75% to 80% on innovation and the rest on maintenance. So that is a huge benefit for us, not just from an IT spending perspective, but the opportunity to innovate to drive additional cost reductions which are going to be more in the business silos.

Real estate is also on plan. Real estate, what we have talked about is it being material although not as large as IT and the full year's run rate savings in real estate is in 2010. And we are making good progress there. So there is no -- at the shared services level, there is no new news there, continuing to execute.

Then we have also talked about initiatives that are really in what we call our business lines so our cost of service delivery. The beauty in the EDS acquisition is that we now are pulling EDS into those exact same cost initiatives and they are really around right shoring, standardizing, optimizing, and automating process as much as you can.

One of the key things about the offshoring is that you create hubs. And once you create hubs you have got a bunch of processes in one location and you have the opportunity to do this optimization, standardization, and automation. We are continuing to execute on that and like I said bringing EDS into it. So they fit in perfectly into those same initiatives.

Then in IPG the other area we have talked a lot about costs. The good news is that IPG has been a very profitable business unit for HP for a long time. The bad news is they have been a very profitable business unit for HP for a very long time and as a result it never got much management attention. If you are bleeding in PCs or bleeding in industry-standard servers from a profitability perspective, where do you put your energies? You go there.

We are now at a point where we are focusing much more on IPG. We started this, I would say 12 to 18 months, the competitive environment is suggesting that we move more quickly and we are. Because the more quickly we can get the costs down in IPG, especially from a cost of sales perspective where a lot of our initiatives are focused, it will allow us to actually go after units that today are just not profitable enough and don't make sense for us to compete for. If you get your cost structure down so that you can go after those units, it just opens up more possibilities to continue to build share.

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**Scott Craig** - Banc of America Securities - Analyst

Questions from the audience at all? Unfortunately, I can talk forever.

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

So can I.

**Scott Craig** - Banc of America Securities - Analyst

When you look at the IT infrastructure at EDS that was an area where, correct me if I am wrong, but I think you guys are running at when you first did the initial data center consolidation, numbers were running at like 3.5% of sales from a cost perspective. You thought you could bring it down to 2%. How much worse is EDS and is 2% still just a number to drive to for the total combined organization in EDS standalone?

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

It's not a realistic -- the 2% is not realistic at this point in time because the outsource services business is a significantly different business and from an internal IT perspective has bigger demands. So when we go when we look at, okay, what is the right goal for EDS or I would say outsource services from an internal IT as a percentage of sales, we go out and we look at specifically for that type of business.

At the HP level, of course, you have got an outsource services business but you also have a really big PC business which has a different demand for internal IT. And so when we are getting -- we are going to get EDS to what we believe is best-in-class IT as a percentage of revenue for an outsourced services business and we are focused on that. That is one of the areas where we are going to get significant savings.

The beauty in it is that we are able to bring them onto our three pairs of next-generation data centers without expanding the data centers. So that means we can move more quickly because we can basically get the equipment in there and move the apps, whereas with HP you had to first build out a number of greenfield sites for the next -- the data centers that we built, these three pairs. So we are going to move more quickly with EDS and they are going to benefit more quickly, obviously, from the savings going to the next-generation data centers that we have already built.

**Scott Craig** - Banc of America Securities - Analyst

Then you mentioned IPG as being a focus from a cost perspective going forward. Can you get a little more detailed on that? Where do you think the opportunities are because it's a fairly profitable business for you guys? Where do you think you can pull some levers to squeeze some more profitability out of that business?

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

The biggest area is in cost of sales and there is a number of different things that we are working on in that space. Some of it's around the actual printers and some of it's around the cartridges or to the ink supplies that comes with it. There is just real opportunity there and I would say that in '08 we are roughly 20% of the savings opportunity we realized in -- over the course of '08. And so there is still lots of opportunity in that space.

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I will say that what we would like to be able to do is take those savings and reinvest them into the franchise to expand the franchise, expand the ecosystem that we play in in printing so that we can, of course, generate more supplies revenue and profits down the road. If that is not -- if the opportunities are not there to the same extent as they way the costs coming out there will be, I guess I would call it upward pressure on operating margins.

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**Scott Craig** - Banc of America Securities - Analyst

From a share repurchase standpoint, how important is the share repurchases going to be to EPS growth as you look over the next couple of years from your perspective?

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

I don't think it's going to be necessary to get good EPS expansion. We are just not going to have to do a significant share program. And what we have really talked about, at least in the relatively short term, so I would say 12 months, 12 to 15 months, is that with the capital that we have deployed for EDS we will temper our share buyback program.

We will be active in our shares, but it won't be at the same pace as we were active in our shares last year. Last year we spent roughly \$11 billion on share repurchase. You won't see us spend \$11 billion on share repurchase going forward in the next 12 months, but we will be active.

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**Scott Craig** - Banc of America Securities - Analyst

And is the share repurchase program, is it dependent on price or is this just the standard program where you guys are just fairly active on a quarter-to-quarter basis?

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

There are really two pieces to our share repurchase program. One is offsetting dilution that we get from employee benefit programs and that is less price sensitive. Then the other piece is to be more opportunistic in the market and that is -- we definitely look at price when we buy on that part of the program.

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**Scott Craig** - Banc of America Securities - Analyst

Then for a -- last question here because we probably got a minute left -- from a software perspective it's one area where investors would say there could be a focus going forward over the next couple of years. How do you think about the software business from an acquisition perspective and growing that business?

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

It's interesting the way you phrased it that software might be an area of focus going forward. Software has been an area of focus. We have made a number of significant acquisitions in the software space with Mercury, Opware, SPI Dynamics and then around our information management platform TOWER. We will continue to build on that. We will invest heavily with organic R&D. We will continue that program and we will look at acquisitions that make sense to kind of tuck-in and fill out that portfolio.

From a strategy perspective, we have really got kind of the big picture software strategy is really a round owning management. And that is management of your infrastructure and management of your information and that is the -- those are the areas that we are going to really focus on.

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**Scott Craig** - Banc of America Securities - Analyst

Okay. That is it. We are out of time. We are going to be doing a breakout right after this, so hopefully we will see you all there. Thanks a lot, Cathie. Appreciate it.

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

Thank you.

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