FINAL TRANSCRIPT

Thomson StreetEvents℠

HPQ - Hewlett-Packard at Barclays Capital Global Technology Conference

Event Date/Time: Dec. 09. 2008 / 11:15AM ET

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PRESENTATION

Ben Reitzes - *Barclays Capital - Analyst*

Thank you for joining us for the Barclays Capital Global Tech Conference. I am Ben Reitzes. I am the IT hardware analyst here. And I am pleased to be kicking off the conference with a keynote from Hewlett-Packard. With us today we have Cathie Lesjak, the CFO of the Company, and Jim Burns, head of Investor Relations.

First, I would just like to welcome you again. Thanks for so many of you joining us in these interesting times. I think it is going to be a great conference where, hopefully in addition to tone, we hear a lot about how companies can shape up in this environment that looks obviously pretty challenging in 2009. I expect a lot of great contact. And we have a ton of great companies here. And we thank you all for coming from the corporate side as well.

I joined the team in March and have been delighted to be here. I just want to name a bunch of folks on the tech team who have put in a lot of great effort in terms of making this happen on the research side. We have here Tim Luke and Romit Shah from the semiconductor team. From the communications team we have Jeff Kvaal and Amir Rozwadowski.

From the software team we have our colleagues, Israel Hernandez and Eric Handler. And from the semi cap side, C.J. Muse is here. And from the solar side we have Vishal Shah. Also on the imagining side we have Vishal Shah. Also on the imaging side we have Carol Sabbagha's team here. And from our Washington and economics team we have Tim Wallace and Ethan Harris. So I will make sure you guys all get to meet the team.

With that, we're going to get started with the first keynote, where we will go through a fireside chat and then open it up for questions. I also want to say that after this, the breakout will occur actually right here in this room. So if you wish to stay, we will take maybe a minute break, and then just push up in an orderly fashion, and you can stay for the breakout when we conclude.

Everyone read that. And, Cathie, thanks for coming.

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

Thank you for having us.

Ben Reitzes - *Barclays Capital - Analyst*

I obviously have a list of questions here. First of all, you guys are in the midst of a major cost-cutting program. You've bought EDS, where in September you had a major meeting where you outlined savings there. But then in your most recent conference call you talked about accelerating $1 billion in savings this year.

Could you just talk about $1 billion, which is about $0.32 a share, could you talk about where it is coming from? And is that booked this year, is it runrate by the end of the year, and how are you getting there on an excelerated fashion?

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

I think the first way to talk about it is that it is booked this year. And we are really focused on the initiatives that we have been focused on for a while in the corporate overhead space. And you add to that the EDS savings that we expected to get, that we talked about on our security analysts meeting in September.

On top of that, we have the continuing initiatives in HP Services and in IPG that obviously are also going to give us additional savings this year, and allow us to do even better on the cost saving side.

I also think it is important to think about the fact that we do a lot of planning. We do a three-year planning cycle on a regular basis. I think we're probably unusual in that we rollup our three-year plan every quarter, and look at it again. And it gives us the opportunity to plan for the future.

If you will look back at some of the things that we did in fiscal '08 with respect to workforce rebalancing throughout the year, we made significant -- we took significant charges in the course of the year in order to set us up better for '09. That is really what seeds the pipeline and seeds the billion dollars on top -- on a constant currency basis. So we've got -- we just have a lot of different things going on in the cost space.

On top of that, given the slowness in the economy, and our concern about that, we have done what I would put in the category of belt tightening. Things like cutting down on travel, deferring salary increases, looking at our agency contractor spend. All these types of things that are on top of the $1 billion that we have talked about for '09 that give us yet again another cushion.

And it really allows us not to have to cut in our muscle. And when we talk about what is the muscle of the Company, what is going to keep the Company in great shape, it is really around our go to market, our sales resources, our customer service and our R&D investments. Those are all very well protected. And we're doing all of these things around that to make sure to protect it.

Ultimately it will allow us to continue to make the right investments organically, inorganically in order to come out of this slow economy, frankly, a much better competitor than we are today.

Ben Reitzes - *Barclays Capital - Analyst*

Just to follow-up on the cost-saving side, when you had your meeting in September you talked about $1.8 billion in savings. I believe that is net pretax over three years, with 24,600 positions eliminated. You take out $1 billion this year, does that mean that the $1.8 billion is relatively conservative net of reinvestments, or does that mean that that is still the target and that takes over three years and whatnot?

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

You really need to take that -- the target is really $2.5 billion. We believe roughly $1.8 billion will fall to the bottom line as a result of the reinvestment activity that we're going to do. We have committed -- I'm sorry -- the vast majority of that is for the 24,600, which is now another 100 more than that. We committed that we would get roughly half of that done in '09.

There is no question in the current economic environment that we're very motivated to do that more quickly. So I've got every confidence that we'll get at least half of that done in '09.

Ben Reitzes - *Barclays Capital - Analyst*

Great. I wanted to talk about a couple of other big picture pressures. One in particular is actually currency. You guys have guided for a 600 to 700 basis point hit for this fiscal year, FY '09, as a result of currency. But you're hedged. How much does it fall to the bottom line or doesn't with regard to the 6% or 7%, how you are managing that?

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

Unfortunately this is complicated. It is complicated because, of course, we have got a variety of businesses in our portfolio. If you look at PCs as an example, the ability to reprice PCs is relatively good and quick.

If you go at the other end of the spectrum and you are looking at business critical servers, which is a significant backlog, or you're looking at services, it is harder to reprice that revenue quickly.

So what we did was we did all this math for you, and we put it into our guidance. And so our guidance for the year clearly takes into consideration the 600 to 700 basis point headwind from a currency perspective.

Now hedging. Do we hedge? Yes, we hedge. What is our philosophy? Our philosophy depends on the business that we're talking about. If we've got a business that frankly turns -- can be repriced very quickly, and has competitors that are typically dollar based, then we will hedge shorter, because you have that opportunity to recoup.

So we really look at our hedging strategy based on how quickly can we reprice from a competitive perspective as well as from just a backlog and a business model perspective. So there are hedges that are as short as a month, and there are hedges when you look at the services business that are six to twelve months out.

Ben Reitzes - *Barclays Capital - Analyst*

Your guidance this year is at least $3.88 to $4.03, I believe?

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

That's right.

Ben Reitzes - *Barclays Capital - Analyst*

You have had hedging in there as the currency impacts. What about in terms of receivables? For example, it looked like the bad debt provisions went up quite a bit last quarter, but you also do have quite a bit of business with EDS and GM, etc. So does that really bake in additional reserves throughout the year for potentially bad debt?

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

There is some contingency for bad debt for sure. Let's back up a bit and let's make sure everyone understands the process that we use with respect to our reserves, because we have a very disciplined, rigorous process. We are an analytical Company, and as a result, we basically look at expected default probabilities. We ran Monte Carlo simulations across our receivables, our class of customers, to really have a sense of what the probability is of losses, and then put reserves in place as a result of that.

We definitely have seen across our portfolio, just like any other company, that the expected default probabilities had been inching up over the last few quarters. That is why the reserves have started to come up for sure.

Then we look at companies that we need to take a more specific reserve for because they are of more concern to us. And I would certainly put Circuit City in that category, and to a certain extent GM as well.

GM is a big customer of ours. We're very important to GM as well, because we're run critical data centers and manufacturing IT to back up their manufacturing processes. Coming out of Q4 we do believe that we are appropriately reserved, both for all of our customers, and GM in particular.

Ben Reitzes - *Barclays Capital - Analyst*

It looks like on a runrate basis you are even hundreds of millions more reserved, so that is baked into your guidance.

With regard to -- let's get into the businesses. With regard to PCs, there has been a lot of talk of fixed versus variable costs in this tough environment. I have been running with an estimate of about 10% of your costs maybe in PCs are fixed. Could you -- do you talk about that? Can you talk to that? And how do you manage margins in this environment among your variable costs structure within PCs?

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

We don't give a lot of specific data on the variableness of our cost structure across our different groups. But certainly PCs is highly variable for us. It is at one end of the continuum. We also -- and that is really from the fact that we do a lot of outsourcing, whether it is around call centers, whether it is around our contract manufacturing contractors that we use. It puts a high degree of variableness into the cost structure.

Then if you look at what would be, I would say, the fixed nature, other than corporate allocated overhead, the fixed nature is even only fixed over a quarter or two. When you think of the PC cost structure as being very variable, almost entirely, except for corporate allocated overhead, in the course of a quarter or two.

That obviously gives us a lot of levers when revenue starts to come down. And gives us a lot of confidence, frankly, that we can manage our EPS guidance.

Ben Reitzes - *Barclays Capital - Analyst*

There is a couple of crosscurrents there. You have PC demand obviously doing what it is doing, but then you have the shift to netbooks. But you also have component prices getting more favorable, by the day it seems, to find their own fixed cost basis for your suppliers. But with regard to that, that is all baked in, and it gives you confidence in your 5% plus range in terms of the margins?

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

It does.

Ben Reitzes - *Barclays Capital - Analyst*

With regard to IPG, your printing business, last quarter that was a little light on the hardware side that SPAR did great. There is -- some folks have a fear out there that the hardware install trend will start to impact supplies logically.

Could you talk about that dynamic, and how it would impact the business, and how you're planning around that? Do you feel that there is a supply -- do you feel like supplies can continue to grow, grow nicely, even with what we are seeing with installs?

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

I think we set ourselves up on this one, to be honest with you. What is really important in the printing business is the installed base, and whether or not the installed base is stable, declining, increasing, and whether or not they are printing clearly.

And in the past we have given shorthand metrics for whether or not the installed base would be growing or not. And the shorthand metric is if hardware unit growth is there, and we're not participating in that growth significantly, then the implication for our installed base is that it would be declining.

But in an environment like we are in now, where units, printer units, are actually declining, and we are maintaining or gaining share, that would suggest that our installed base is at worst, stable. And so we are confident in our installed base.

Then you've got to look at are they printing or aren't they printing? And that really -- there is no great metrics to tell you whether or not the printing -- that those people are printing at the same rate or not. But one metric we do look at is cut sheet paper growth. And that has been, depending on who you talk to, a little down, a little up, so we are thinking about it as being flat.

So the combination of having a healthy installed base that is not declining, and printing being kind of stable, would suggest to us that supplies revenues should continue to be relatively good.

Again, we're coming off of two very strong quarters, 9% supplies growth in Q4 and 11% supplies growth in Q3. So in the near term we're looking at low to mid single digit growth in supplies. We still think the long-term sustainable is mid to single high digits.

The other complexity when you look at unit growth that you need to take into consideration is that not all units are created equal. If you look at the growth that we had in our graphics business, when we placed a unit, an Indigo Press, the ramifications for the printing, or the supplies that come off of that, and what the implications are for our unit growth, are totally different than if we basically placed a consumer inkjet printer. So you've really got to take that dynamic into consideration.

The other thing that is going on is that folks are moving to wireless printers, which is absolutely fabulous for HP. Because if -- I don't know about all of you, but I've got three printers in my house, because my kids don't like to move cords around. Well, now with their laptops all over the house, with one wireless printer we do just as much printing. So I buy just as much cartridge -- as many cartridges, but I only have to buy one hardware unit. And HP only has to invest in one hardware unit.

That has implications obviously for unit growth in one direction, being down, but supplies growth being flat. And obviously profits for HP having an upward bias.

Ben Reitzes - *Barclays Capital - Analyst*

You've got a supplies price increase, right?

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

We have definitely had a supplies price increase.

Ben Reitzes - *Barclays Capital - Analyst*

That has been for the majority of the world, and held?

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

At some point in the last few months, yes, we have covered the entire world, although we have been it in stages.

Ben Reitzes - *Barclays Capital - Analyst*

Now IPG kind of doesn't get as much press in terms of the overall restructuring of the whole HP, but there has been an announcement there of a reorganization and whatnot. Could you just talk about what you're doing to cut costs in IPG and keep your margin? I believe your margin goal is of the latest, is 15% plus, maybe in that range. Correct me if I'm wrong. There seems to be moves you're doing there that are sort of behind the scenes, anything that we can --?

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

I don't think I would categorize them as behind the scenes. But I would categorize them as we have started later in IPG than we did in our other segments. Part of the recent for that is that IPG has been so incredibly profitable that it wasn't a burning platform. As we have made progress in our other segments, we brought a new focus on IPG. And this started in the early part of FY '08. And we have significant cost initiatives associated with getting IPG a lot less fat than it is today.

Those cost initiatives come in a variety of form. Some of them around overhead. Overhead in terms of, one of the things we have done is we have consolidated a number of business units within IPG to streamline it and to reduce the overhead. But the vast majority of the cost initiatives are really around the cost of goods sold. Looking at SKU reductions, looking at outsourcing parts of our manufacturing process to get it to be more variable, but also to get lower costs.

We're in early stages in this with IPG. We originally were thinking it was a three-year timeline for them to get all these costs out. And clearly in today's environment, with the competitiveness around hardware unit placement and the economy in general, we're doing everything we can to pull those in, and move much more quickly on the cost reductions in IPG.

In terms of the right model to use from an operating profit perspective, the guidance that we provided that at last year's December security analyst meeting, was 14.5% to 15.5%. There is upward pressure on that number. If you look at the cost savings -- you look at the fact that we have not had to place, and we don't expect to have to place as many units to get the supplies revenue, plus the supplies price increasing. So there is definitely upward bias there.

We would love to be able to invest that in our graphic arts business, in our enterprise business. And I think we are just going to have to wait and see what the right set of investments are to know whether or not it is 14.5% to 15.5% or it is higher or it is right in that ballpark.

Ben Reitzes - *Barclays Capital - Analyst*

I wanted to move into the enterprise. You gained share in servers recently, but there still was a little bit of a miss on the top line vis-a-vis expectations on servers. Not nearly to the degree of Dell or IBM or Sun, but nonetheless the server market is very tough.

You still had good margin in that business. You still had good storage. What is going on in the enterprise? How are you -- servers just seem really weak, and you still are executing in margins. When does that hit storage margins and service, or can you navigate through it and keep these margins up, like you have been doing?

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

I think it is really important -- it is a tough market -- it is really important then in these tough markets to look at margins, but also to look at whether or not we are maintaining or gaining share.

We actually had a very strong Q4, where we grew in industry standard servers roughly double what the market grew. So we're very pleased with our performance there.

We're getting a lot of our growth from the servers from blade, from cloud competing. And then broader for industry standard servers in storage -- from storage. Our storage business was up 13% in Q4. And within our storage business, our mid-range product, our EVA, was up 15%, which was better than most of our major competitors in Q4. We believe we are very well positioned in a tough market to continue to do well.

We clearly have cost initiatives, kind of corporate overhead type, shared service type cost initiatives that are starting to bear fruit. And enterprise storage and server benefits from that. Then they have their own set of cost initiatives, specifically around how fixed their cost structure is, that allows them to continue to perform well from a margin perspective.

Ben Reitzes - *Barclays Capital - Analyst*

I asked at the last downturn that division was where the revisions got pretty scary. The swings in margins, I mean, we're talking plus 8% going to minus 8%. Those kind of things. It sounds like for now you obviously don't see that, and you are managing through it. But do you feel like share gains are going to be a big part of your ability to maintain there and keep your volume at least higher than the industry?

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

I do think share gains are going to be -- we will be able to continue to gained share there. And I think the best moves for all of our investors is that -- we're going to gain that share, and we're going to do it profitably. It doesn't matter what group you're in within HP, our strategy is profitable growth. We are not going to go after stupid deals.

We will go after deals that are not as profitable in the short term if there is some sort of aftermarket or opportunity to get those deals more profitable. But we're not going to change -- in this environment we're not going to change our direction to our sales force around profitable growth.

Ben Reitzes - *Barclays Capital - Analyst*

I am going to ask two more questions, and then we will open it up. We still have plenty of time for some good Q&A from the crowd. So get thinking about what you're going to ask.

In terms of services, you just announced that you -- well, I don't think it was a surprise, frankly, but a little bit of a realignment of how EDS would like inside HP. Could you just talk about the deal? It seems like you're pretty happy with it. And the structure there, and the synergies a little bit, just where you sit today? You just put out a nice release yesterday, I believe.

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

We're very pleased with the EDS acquisition. The customer response has been incredibly positive. Both before we closed, as we were closing, and now as we really have an opportunity to engage with customers, the response has been positive.

We also think it is just a tremendous opportunity from a cost perspective. And again, as I mentioned earlier, we are focused on doing that more quickly than we had committed to the Street, given the environment that we are in.

The other really fortuitous event is that in this type of economic environment, services is somewhat countercyclical, especially when you look at outsourced services business. So we're getting lots of opportunities to do more on the revenue side.

We actually need to keep the discipline of taking the deals where we can make good money. So we don't want to get growth for growth's sake. Again, we are focused on profitable growth. We think there is just a lot of opportunity out there.

It is really changing the conversation that we have with our enterprise customers, which we thought that would be the case. I am not sure we expected it to happen quite so quickly. And the economic environment is obviously helpful in that environment in that case.

I did talk earlier about the cost base, $2.5 billion on a gross basis. That could drop $1.8 billion to the bottom line. And it is just overall, all around we're pretty pleased with it.

The actual announcement that we made on Friday around Ron Rittenmeyer retiring, it is kind of what you would have expected. He was great and instrumental at getting us to some key milestones. We got there, maybe a bit sooner than we had anticipated. And he is deciding to retire. That is allowing us to pull in the EDS business into closer to our Technology Solutions Group. And it will allow us to streamline the go to market and the synergistic opportunities more quickly.

Ben Reitzes - *Barclays Capital - Analyst*

Finally, just on cash flow, last quarter you mentioned that you had -- or in October you mentioned that -- November, I'm sorry -- you mentioned that you would have very good strong cash flow against this year. Could you just talk about what makes you so confident in this environment that you could generate good cash?

You have been generating free cash in excess of EPS pretty much on average since Mark got to the Company. It has been pretty impressive, unlike some of your peers. But any comments there?

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

Cash flow has been an incredible focus for us at HP, certainly over the last two years for sure. And we generated $12 billion in free cash flow last year, which is a 68% increase over the year before. And that has really come from cash earnings and a maniacal focus on working capital and working capital management.

Within the cash conversion cycle the last two years we focused on inventory management, and made great progress at reducing our days of inventory, in working capital -- in inventory. We have done a good job in the more recent past around managing our DPO or our Accounts Payable. We have got targeted programs and initiatives around making sure that we negotiate good economic terms with suppliers, and then not paying quicker than that.

You will probably laugh, but we had outsourced to our BTO organization our Accounts Payable. And one of their metrics was making sure that they paid on time or earlier. And so we went back to them and said, no, no, no, that is not the right metric in the case of Accounts Payable. You want to pay on time, or if it slips a day, you are kind of okay. That is the type of focus that we're putting in place.

There is a bit of a headwind with Accounts Receivable, no doubt about it, because of the credit crunch to some extent. And then more importantly to the fact that we've got just a bigger enterprise base with EDS, and they tend to negotiate more extended terms and pay a bit slower. But net net we still believe there is opportunity in the cash conversion cycle going forward. And that, combined with earnings, will allow us to continue to generate very strong cash.

Ben Reitzes - *Barclays Capital - Analyst*

Great. Well, I believe we have three microphones floating around. And lets take a few questions. And if it gets slow I will think of --.

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

You will fill in.

Ben Reitzes - *Barclays Capital - Analyst*

I will fill in.

QUESTIONS AND ANSWERS

Unidentified Audience Member

Can you talk just briefly about what your outlook is for your networking business, how you expect that to evolve over the next two to three years, and what are the drivers for you getting more aggressive there?

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

I am not sure I would say that we're going to get more aggressive there. It may not have been as obvious to everyone, but we have been aggressive there. We have been growing that business in the, I don't know, 20%, 30% range plus over the last number of quarters. And we will continue to do that.

It is clearly -- bringing it into our Technology Solutions Group, reporting to Ann Livermore, is a very positive sign for that business. We're going to have a broader salesforce selling ProCurve, which we believe will continue to drive really strong growth in that space.

We're very pleased with both the top line growth as well as the profitability of ProCurve. It is a great value proposition in today's market. It has got great price performance in the mid range of the network.

Unidentified Audience Member

Any thoughts of moving that out of corporate investments and putting it into ESS, so we can start to look at it as part of the broader enterprise business?

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

We're really excited about doing that. I'm teasing you. We will -- when it gets big enough. When it gets bigger, we will absolutely pull it out and put part of the -- one of the groups within Technology Solutions Group. This year we're not though.

Unidentified Audience Member

Do you have the capacity to do another acquisition, given the size of the EDS integration?

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

We have the capacity to do another acquisition absolutely. The question is, how big is that acquisition. At the end of the day we want to get well along our way in terms of integrating EDS. As we do that, we obviously will look at acquisitions of larger size.

Right now we're looking at acquisitions that are -- that tend to be smaller in nature. And we have absolutely no concerns about being able to digest smaller acquisitions, or acquisitions, frankly, that are in nonservice-related segments. An IPG or a PSG, those ones are really not that affected by the EDS acquisition, and therefore, there is obviously more appetite, more capability to absorb and integrate an acquisition in that space.

But more broadly, when we look at it from a -- there's the capabilities and then there is also, do you have the cash? Do you have the capital that you want to go after that? And we are in the process of obviously building that capital back up.

If you look at basically our net cash position, we have a net debt position coming out of Q4. And what we mentioned at our security analyst meeting in September, when we talked a lot about the EDS and the services business, is that we're focused on getting back to a net cash position in four to six quarters, including HPFS debt. And with the cash generation that we are coming up with at this point, we are well on that path.

Unidentified Audience Member

Just on your comments about profitable -- wanting to grow profitably, the market share gains for HP, I am currently skeptical here. But you had two and a half years of market share gains against Dell. And I do remember in '04, '05, Michael Dell was crowing about market share gains against you guys. And we know how that ended, in a spiral down for Dell as they tried to grab market share through price, a price war.

In a shrinking pie, which is what we are all looking at possibly in '09, I don't see how we can avoid a price war in the PC market.

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

HP is a very different company today than it was then. We have done a tremendous amount of work on our cost structure, and on our ability to be more competitive at a profit.

We've got a great lineup of product. We've got product in the right -- in the sweet spots of where growth in the market is, around netbooks. And we've made the investments in emerging markets. That is also where the vast majority of the growth is coming from. We've got the right channel networks. So we believe we're very well-positioned to be competitive.

Again, as I mentioned, we're not interested in doing stupid deals. We will aggressively compete, but only where we can do it profitably. If at the margin that means we have to walk away from market share gains, then we will. At this point in time, we're not anticipating that to be the case. But obviously, one of the things you need to take away is that our focus is on profitable growth.

Unidentified Audience Member

Did the opposite happen last quarter? Because Dell seemed to have missed the top line more than people were expecting, but beat margins. It seems like they walked away from unprofitable deals. Have you actually seen it be a little less competitive than you would have thought in this kind of environment?

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

We haven't really seen Dell significantly different over the last number of quarters. So there was a big concern that Dell was going to get more aggressive, I think, a couple of quarters ago. And we got lots of questions about that.

But for us Dell just hasn't fundamentally been really different quarter to quarter in the PC space. That is not true in the industry standard server case. In Q2 Dell got very aggressive in the industry standard server, and we saw significant ASP declines in Q2.

Since then though the quarter-to-quarter changes in ASPs have been roughly normal seasonality. So the real aggressiveness in the market, and I would attribute some of it to Dell, has been more normal in the last couple of quarters in servers.

Unidentified Audience Member

Can you talk a little bit about the impact of virtualization over the medium to longer term on your server business, and even on the computer business?

I was reading where IBM introduced some sort of a thin client application where you can run say 12 desktop computers off of one server for like $150 a pop. Can you talk about how that impacts both of those sides of your business?

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

In general we view virtualization actually has being pretty positive for HP. The reason why we view it that way is that it is an opportunity for change to take place. There is a disruption going on in the market. And we have a very solid product lineup right now. A product lineup that is very attractive in the modern data center. And that is just going to give us an opportunity to get our fair share, or better than our fair share, especially when you think about blades.

Blades is a common destination in this as folks modernize the data center. Right now we've got over 50% market share in industry standard blades. Industry standard blades last quarter grew, I think it was 33%. That compares to our competitors that are not growing at all, or are growing in the single digits.

We continue to have a dominant position in blades. And that is critical to when you buildout the data center. That is a very sticky piece of business. It is industry standard component, but for proprietary software and technology within the enclosure. And it is extremely sticky business. So we think we will do very well as -- and have been doing very well -- as folks modernize their data center and do virtualization.

Unidentified Audience Member

A couple of questions on mobile computing. You guys obviously don't have much of a presence in either smart phones, or to a lesser extent netbooks and the like. How important do you feel that getting into that line of business is going to be important for the future?

Second, regarding your emerging markets with notebooks, do you see guys like Acer and ASUS, which had been much more aggressive with low-end netbooks in the emerging markets, is that affecting your strategy at all?

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

I'm sorry, I didn't hear the first part of your question. So I will answer the second part of your question, and maybe, I don't know if you heard the first one.

We have been competing with Acer for a long time. And clearly a number of years ago we struggled against Acer. We didn't have the right product lineup to go as aggressively and compete with Acer. Today it is a different environment. We've got the right product lineup. We've got netbooks. They have got netbooks. And we believe that we are well situated to go after.

But, again, our focus is going to be on profitable growth. And so there are probably some parts of the very low end that Acer and ASUS will go after that we're not going to go after as aggressively, because we are focused on profitable growth. But we feel we're very well lined up to compete with both Acer, ASUS, as well as Dell and Lenovo.

What was the first question?

Jim Burns - *Hewlett-Packard - Director VP, IR*

The first question was around committed to the smart phone market. So we are in the market today. Obviously we haven't been entirely pleased with the success we've had in the marketplace. We are coming out with new products that are being launched, and we will have high hopes for it. But clearly it has been an area that hasn't been as a strong point for us, like it has in other parts of mobility, for instance for notebooks.

Ben Reitzes - *Barclays Capital - Analyst*

I want to ask you kind of a funny question in a way. It is just I have a hunch you're going to sound better than some of the friends that we are going to hear from later in the conference.

We have heard from -- releases from Ingram, Tech Data, Arrow, AVNA and whatnot, and many semiconductor companies that has extremely dire forecast. Your forecasts aren't so bad. You have great earnings. Revenues have been cut a lot. But the people out there are wondering why does HP sound better than those that you're paying to make your product, some of these people -- or to distribute them? Are you cutting inventory very aggressively and being proactive? You don't have to say, who, what, where or when, but there's obviously a disconnect a little bit.

You guys sound better than a lot of the peers and a lot of people in the chain. Just is there a way for you to summarize that, to give us a sense of realism here about the environment we're in and where you're coming from a little bit before we end?

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

I think the best way to summarize it is that we have every bit of fuzziness around our forecast for revenue as anybody else does. We don't know what is going to happen on the top line. We are focused on the things that we can control, and that is really around our cost structure. And we believe that we've got the right belt and suspenders, and another set of belts and suspenders in the cost side of the house that will allow us, within a fairly wide range around revenues, to still deliver our EPS.

Now we've also got, are there benefits that certainly some of our contract manufacturers may not have, and even some of our broader competitors don't have, and that is really around a reoccurring revenue base.

We have really scrubbed our reoccurring revenue. We think it is roughly one-third is recurring in this kind of environment. And that that generates over half of our profit. So that, again, gives us confidence that we can hit our EPS, even if revenue is lighter than what our guidance would suggest it to be.

Unidentified Audience Member

The question is on geographic demand. Can you please give some color as to what you are seeing in Europe and in emerging market, Asia -- and in Asia?

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

Emerging markets continues to be very strong for us. Even within Europe there are -- you can't even say in Europe that developed countries were terrible; they were spotty. So emerging markets, we can make a comment around emerging markets being strong. And then within the more developed nations, there were places where you got reasonable growth, and then clearly, obviously, in the US where you didn't get growth at all.

But it is really not one size fits all. I just couldn't make a broad statement about it, other than to say emerging markets has been -- continues to be strong for us.

Unidentified Audience Member

Just for planning purposes, are you assuming that emerging markets will continue to stay strong? Is that the way you are thinking? Or do you expect emerging markets to go [lower] as the US (inaudible) maybe six to nine months -- with a six to nine-month lag to US?

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

We still expect emerging markets to be the growth engine for us. It will clearly be offset by slowness in other areas. If you actually look at the guidance that we provided, if you take out EDS and you take out currency, our guidance for revenue for FY '09 is roughly flat.

And, again, within a range around flat, we do believe that we can continue to deliver our EPS guidance of $3.88 to $4.03, which is 7% to 11% growth over last year.

Ben Reitzes - *Barclays Capital - Analyst*

I think we're going to stop it there. And just remember, we're having the breakout session right here, so those that want to stay maybe move up. And get to your next presentation as well.

Thank you so much. You did a wonderful job. Thanks Jim. Thank you very much Cathie.

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

Thank you.
