FINAL TRANSCRIPT

Thomson StreetEvents℠

HPQ - Hewlett-Packard at Goldman Sachs Technology and Internet Conference

Event Date/Time: Feb. 26. 2009 / 2:00PM ET

CORPORATE PARTICIPANTS

Cathie Lesjak
Hewlett-Packard - EVP, CFO

David Bailey
Goldman Sachs - Analyst/Moderator

PRESENTATION

David Bailey - *Goldman Sachs - Analyst/Moderator*

Great. Good morning, everyone, and thank you for joining us. I am David Bailey from Goldman Sachs. I am joined by Cathie Lesjak, the CFO of HP. We are very happy to have Cathie here today.

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

Thank you for having me.

David Bailey - *Goldman Sachs - Analyst/Moderator*

You're going to start with disclaimer.

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

I do; I have the boring part of the presentation.

Before we get started, I want to make sure you are aware that this presentation may contain forward-looking statements that are subject to risks and uncertainties. Please refer to HP's SEC reports for a discussion of those risks.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Thank you.

We understand that HP doesn't usually talk about the macro environment so much, but given your product diversity and geographic diversity, it would be very helpful if you could at least give us an update on sort of how the demand trends are going right now.

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

So David, it's hard for me to talk about the macro environment. But I can tell you, talk a little bit about how we did and what we saw in Q1. You kind of bifurcate kind of consumer and SMB from enterprise. So in the consumer and SMB space, we saw a fairly sharp decline in the latter part of November, and then the rest of the quarter was kind of at the same sort of level, so not very good.

On the enterprise side, it was a different situation. We saw a more typical budget flush in December, and then we saw the sharp decline in January. So it was a little bit different depending on segment.

David Bailey - *Goldman Sachs - Analyst/Moderator*

When you think about the enterprise dropping off in January, do you think a lot of that was because budgets were still in flux, or do you think it's more of a sort of intermediate or longer-term phenomenon than that?

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

You know, at some level, it's very difficult to sort out kind of which it is, one or the other. But there is absolutely no question that, in this environment, IT budgets are under a lot of pressure. That means that things that are more discretionary in nature, like whether or not it's an optional upgrade on the server, is going to get delayed.

But what's really exciting for HP and important for HP is that the discussion is changing with the CIOs at these companies, and they are really talking to us about how can they cut costs. How can they variablize their cost structure on the IT side so that they can in fact continue to manage the demands on their legacy infrastructure. They come to HP because HP, frankly, has done it themselves. We have cut our IT budgets in half and increased our capacity. So they view us as kind of having gone through the pain and know how to do it.

The other thing that is very positive for us is our position in the ITO space with the acquisition of EDS and the capabilities that we've built as a result of that. That is a way for folks to lower costs and variablize costs. So we are getting a lot -- we are having a lot of opportunities with customers around that.

Then the other interesting thing that you all may not have really thought about is that, at some level, our maintenance contracts are a little countercyclical in the sense that, as people elongate and hold onto their servers longer, they need more -- they are looking for the maintenance contracts. So we are seeing a fairly solid uptick in renewals.

David Bailey - *Goldman Sachs - Analyst/Moderator*

You touched on this a little bit, but when you talk about customers trying to make their costs more variable, is that more of a comment about what you can do on the hardware side, or the financing side, or the outsourcing side?

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

So I think it's a combination of those things, but certainly one way to make them more variable that's the most obvious is to basically outsource their IT and then buy what they need when they need it. That really helps them kind of manage their costs kind of as they see the demand environment.

David Bailey - *Goldman Sachs - Analyst/Moderator*

As you look forward, you have three customer segments. You are relatively well balanced between consumer, SMB and enterprise. How do you think about the relative strength of those areas as we go through 2009?

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

I think we should probably step back first. If you look at Q1 and the softness that we saw in Q1, it was global. In fact, if you adjust for EDS and currency even across our regions were roughly performing the same.

In terms of customer segments, again, I've already kind of called out the fact that, in the enterprise space, we did see a little stronger December and then a drop-off in January. Other than that, I don't really kind of know how to categorize the segments differently.

It's hard to know what the stimulus packages are going to do for the different segments. These stimulus packages obviously beyond just the US but across the world. So we are going to have to wait and see what happens there. We have a strong market position and product portfolio and actually believe that we will benefit well from these stimulus packages, whether they are across consumer, SMB, or enterprise.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Now, you reduced OpEx dramatically this quarter, down about $500 million year-over-year. How soon did you see demand start to drop off and you could sort of kick in the accelerated cost cuts in the last quarter?

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

When we went into Q1, we knew that the demand environment was soft. We didn't know how soft it was going to be. So, we immediately took some what we would consider more short-term in nature, at least initially short-term in nature costs, discretionary cost savings -- things like we normally shut down in December. We have a one-week shut down, and we decided to make it a two-week shutdown. We immediately put salary freezes in place. We cut travel; we cut contingence, you know, the amount of time we use contingent labor. We did all of these things that you would expect a company to do when they were a little uncertain as to what the economic environment and the demand environment was going to look like. And so we took those actions right away.

But the part of the $500 million reduction in costs is actually more about the fact that we have been making investments to save over the last three years, and so we are starting to see the run rate savings from those actions that we took -- things like IT. 2009 is going to be the first year in which we're going to see a full run-rate savings of $1 billion in IT.

In real estate, we've been talking about the actions that we've been taking on the real estate front. We saw a little bit of savings in '08. We are continuing to ramp those savings in '09 and we won't see a full year's run-rate savings in real estate until 2010.

So it's all those types of things that are starting to come in and play into our cost structure.

We did also have some benefit from currencies. We clearly benefited from the fact that the EDS acquisition or integration is a bit ahead of plan.

David Bailey - *Goldman Sachs - Analyst/Moderator*

So we should think of both of these savings as being semi-permanent -- I mean obviously not the shutdown, but a lot of the other actions that have come in?

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

I think that is the right way to think about them. Many of them are structural in nature. Therefore, when we've got this reduced cost structure, as the economy recovers, whenever that might be, we are going to have a very nice opportunity for earnings expansion and cash flow generation.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Now, you saw a much bigger price decline in the January quarter than you've seen in quite some time across multiple product categories. Some of that was mix and some of that was component prices.

On the mix side, why shouldn't we think that that's going to be longer lasting as processors get more powerful and the technology advances -- that you'll see a bad mix shift kind of ongoing, going forward?

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

If you look at where we saw the most pronounced ASP declines, it was actually in the PC space. That was due to a combination of things. There was currency was involved in that; there was clearly pricing as we passed through commodity price declines; and then there was a mixed impact as well. But the mix impact was a combination of moving to lower-end, less-configured products, and then also a little bit to Netbook.

What's important, though, at the end of the day, is that there is ASP pressure and then what happens obviously on the margin side of the house. We have made a lot of cost cuts in PCs. We have a highly variable cost structure. So that's going to afford us some protection, going forward, on the PC side.

If you look at industry standard servers, our ASPs sequentially actually were up a little. That was due to better attach in both memory and storage, so we actually saw an uptick there. Then in the IPG space, there were sequential declines but they were not as significant as we've been [saving] because that had a mix shift actually to the high-end, so the higher usage MSP market.

David Bailey - *Goldman Sachs - Analyst/Moderator*

When you think about component prices -- and obviously that had a factor in the pricing -- were the component prices that dropped so dramatic that it made a bigger difference this quarter than you've seen recently? What do you expect for components over the next few months or few quarters?

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

With respect to commodity prices, we saw a more competitive commodity pricing environment. Let me explain what I mean by that, because if you go back a year and you go back to kind of Q1 of '08, we saw commodity price declines. The difference was that we were not pricing them all the way to the street. In this quarter, we saw much more pricing down to the street of the commodity decline. So it's really the relative positioning of the cost reductions and then how much you pass on to the customer.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Now, when you talk about your recurring revenue, it's obviously a big advantage that HP has. It's around a third of revenue and maybe half of the profits. But there was a dramatic change last quarter in the supplies growth. I assume it sort of broke your model a little bit or was a little bit different than what you'd expect normally out of the model. Do you still feel as comfortable with those still being of a third of your revenue, or should it be somewhat lower than that now?

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

David, it actually didn't break our model. I'm actually glad you asked the question, because it's really important to understand. If you actually look at our revenue by segment and you think about what's recurring revenue, you've got services, you've got parts of software, you've got financing and you've got supplies. When we gave out the data point of it being roughly a third of our business and generating more than half, if you actually add up those component parts of our P&L, it's actually 40% to 45% of our revenue is in that recurring space.

Knowing that we had a tougher economic environment, what I asked my staff to do is kind of scrub that number before we went out with anything. We basically took out a third. It's the things that are potentially more discretionary and not as solid on the recurring side.

The biggest impact where we scrubbed, it was in supplies. We have done many years -- over 30 years, we've been in printing and we've been modeling what happens in different economic environments to supplies -- to end-user demand and supplies. We knew that it was sensitive to what the economy was doing and that we could have pantry destocking. So we modeled back into the analysis, and then I said to them "Take another question, please, before you tell me that it's roughly a third and more than half of our profit." So we've actually got a model that is still holding up, despite the declines in supplies.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Just sort of following up on that as far as the supplies go, it was mentioned that GDP and unemployment are sort of some of the key factors in there. Clearly, both of those got worse between October and January. But it just seems like the drop off going from plus 9% to minus 8% is far more dramatic than what was going on in the macro environment just during that three-month period. So is there something else going on there, or could you point to other periods where we can look at in your past where you've seen the same sort of drop-off correlated with the economy?

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

So there's a lot of different things that actually went into the dump in the growth rate from a supplies perspective. You had very different currency environment. In the fourth quarter, we actually had a tailwind on currency. In the first quarter, we had a headwind. We also did have, as we mentioned in Q4, some pre-buying ahead of price increase, an October 1 price increase that impacted Q4 growth in supplies. So you do get the economic impact.

Then if you look at -- you could distillate it down to then what is the economic impact and you look at what happened in the economies in EMEA and APJ, you saw a pretty sharp decline. That's really what -- it's that kind of decline that drove our supplies deltas.

David Bailey - *Goldman Sachs - Analyst/Moderator*

How long should we expect the sort of negative supply growth to continue?

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

At some level, it really depends on the economy and how quickly folks get through destocking their household inventory because, clearly, for the folks that are continuing to print, as they work through their inventories in the home, they're going to eventually go out and buy more to replace what they've got. Now, they may not buy three and they may buy one at a time, but there is some piece of that that obviously is naturally going to come back.

The channel inventory piece will also naturally come back. But the economic pressure is going to -- I guess you tell me when it turns, and I will tell you when it gets better. We do think that supplies will continue to be kind of negative and maybe a bit worse as we adjust and lean-out our channel inventory over the next couple of quarters.

David Bailey - *Goldman Sachs - Analyst/Moderator*

So following up on the channel inventory side, you were able to very tightly control it on the PC side. On the enterprise hardware side, it went up a little bit, but it looks like most of that will be reversed in the next quarter or so. But on the printer side, you saw a week and a half increase in supplies.

Can you talk a little bit about why that was different than the other categories? Why wasn't it as easy to manage that as PCs or enterprise hardware, and how long it's going to take to fix it?

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

So I think it's really important to understand that week and a half was not just in supplies. It was across hardware and supplies. The fact that, from a dollar channel inventory perspective, we did see -- we did bring it down from Q4 to Q1. So we are making the right -- we are going in the right direction, but sellout just dropped so dramatically in the first quarter that we were unable to completely adjust for it. We did end up with a bit more of channel inventory than we would like, and we are fixing that. We're working through that this quarter. We factored in all of these adjustments into the guidance for Q2 and the rest of the year.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Are there any other processes you can put in place to make sure it doesn't happen again? Or was it just the dramatic drop-off in demand that you just couldn't foresee?

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

Frankly, the processes are in place. This wasn't a process-breakdown issue. This was really just having a more optimistic forecast of what the end-user demand was going to be. Now, we are getting our dollar channel inventory levels more in line with what the sellout is.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Moving onto the PC space, Mark was pretty clear that Netbooks didn't really have a very big impact in the January quarter -- maybe a little bit. But isn't that something to come? I mean, especially because HP is being pretty aggressive in Netbook, shouldn't we see revenue or an ASP and margin hit going forward as Netbooks become a bigger piece of the pie?

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

I think you really need to separate kind of ASP pressure from margin because, first off, we actually believe that Netbooks in the long-term are going to be incremental, will generate incremental revenue and ultimately incremental profit. You also need to look at in Netbooks -- so the Netbooks put pressure on ASPs but still will generate incremental revenue.

The Netbook also has a lower bill of materials than kind of a standard notebook. So again, if you've got good cost structure, even though you've got declining ASPs, you've got incremental revenue, you've got incremental profit. So long-term, we actually think this is positive for PC revenue and profit.

David Bailey - *Goldman Sachs - Analyst/Moderator*

On the same track, Windows 7 is coming out later this year. Can you talk maybe a little bit about what that's going to do with configurations of PCs? Do you think that will continue to put downward pressure on sort of the richness of configurations, and then also what you think it might do to demand on the consumer and corporate side?

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

Just as with Vista, I think we talked a lot about the fact we didn't think there was going to be a Vista moment. We don't think there's going to be a Windows 7 moment either. We are not expecting that there's going to be this huge hockey stick effect when Windows 7 comes out. The good news is that we are hearing positive things about Windows 7.

In terms of despec-ing the PC, I guess at some level we're going to have to wait and see what the market does on that. DRAM right now is so low in cost that, in order to kind of get that little bump-up, there isn't a huge cost -- price increase to the customer, so we suspect that folks will not de-spec the PCs as much.

Plus, you look at what folks are using PCs for in terms of processing and storing rich media video content that all requires more memory, but when you put this all together, our bias is that it's probably not going to get despec-ed. But at this point, we'll have to wait and see.

David Bailey - *Goldman Sachs - Analyst/Moderator*

In the past, HP has done some strategic buying on the component side. Is there any need for that now, or are pricings just so low that you just buy as you need it?

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

We did do strategic buys in Q1. In general, we saw the commodity pricing environment in Q1 to be a buyers market, and for the most part we expect that continues in Q2. But there are some commodities where we think there's going to be upward pressure on prices. It's those commodities that we made some strategic buys in Q1. It was really around assurance of supply as well as pricing, as it typically is for us when we look at strategic buys.

We've had a very good track record of kind of buying at the right time. Frankly, being the largest customer of most of our suppliers gives us a real strategic advantage, both from a buying perspective as well as a buying-ahead perspective. We've really leveraged that in the past and we will continue to do so.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Switching over to PC servers, over the past couple of years, a lot of the competition has either consolidated or faded away and there's sort of only a few players left. But it seems pretty certain at this point that Cisco will be entering the market. What sort of impact do you think that will have competitively? Does it impact your relationship with Cisco?

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

I think you really need to step back and look at kind of the blade market and the fact that a blade solution is really a round virtualizing and modernizing the datacenter, and that is a solution play. It is not just about hardware. It's about hardware; it's about software; and it's about services. It's that entire package that you put together that, frankly, gives you a competitive advantage. Within that package, having IP in each of those spaces is very important. HP has IP on the hardware blade side, whether it's power and cooling or virtual connect so you only have wired the box one.

If you look at the datacenter, we've got IP in dynamic smart cooling so that you can cool a hot spot within the datacenter without cooling the entire datacenter, which obviously, in today's environment, is very important from an energy conservation perspective.

Then from a software perspective, kind of management and automation of the datacenter, we've really built out our management stack in this space and have great IP.

Then on the services side, frankly, we've increased our IP as well. You want to be in the design, the installation, and the support, and we bought EYP that does design datacenters. In fact, HP used it to design our next-generation datacenter. So again, it's a combination of all of those that gives us a competitive advantage in this market and is driving the market momentum that we see.

We also think that scale is a big deal on the hardware side. It allows you to get to the lowest cost in prices competitively as you can. So, that's an advantage for us. That doesn't mean we don't take all competition seriously; we clearly do. Right now, though, with that combination around the solution and the scale, we like our hand very much in this space.

David Bailey - *Goldman Sachs - Analyst/Moderator*

One of the reasons cited that the cash flow came down this quarter was some of the internal inventory increased on the supply side. Were there any other factors on the inventory side that might have contributed to that? How long will it take you to sort of reverse that increase?

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

The inventory uptick, though, was really around hardware, print, and supplies. It was not just supplies; it was kind of across-the-board in that space. We expect to make good progress over the coming months in getting that inventory down. That will mean that Q2 cash flow will snap back and we will show strong performance in Q2. We will also have a good, strong cash flow 2009 because it's not just about kind of unwinding the situation that we had with inventory in Q1. It's really about continuing to make progress in our cash-conversion cycle.

As I've talked about on the earnings call, we still see upside in managing our payables, as well as upside beyond the correction on inventory in our inventory space. Frankly, that will drive very strong cash flow for 2009.

The inventory upside is even beyond 2009 because it's a real opportunity to get our printer supply chain to be as tight and efficient as our PC supply chain, which will generate an opportunity -- will give us an opportunity to generate a lot of cash flow in the future. That's on kind of the POR for us but it takes a couple of years to get this. So we should see a lot of that uptick as well in 2010.

David Bailey - *Goldman Sachs - Analyst/Moderator*

So given that you expect a snap-back in Q2 and sort of given the earnings target that you've set for the year and the working capital or cash-conversion cycle efforts that you're making, can you give us some sort of idea what the cash flow should be for this year, either relative to last year, on an absolute basis?

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

So I think the best way to say it is it's going to be strong. You can look at what the kind of earnings guidance that we provided on the earnings call. Then you should factor in some improvement in the cash conversion cycle. That will ultimately drive a strong 2009 from a cash flow perspective.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Then looking at free cash flow, CapEx is higher now presumably -- mostly because of EDS. Is that going to be an ongoing factor, so we will see free cash flow actually come down versus a pre-EDS HP?

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

So, CapEx will be higher as a result of EDS, but I actually think that's a good thing. We actually think about CapEx in kind of two categories. CapEx is really designed to modernize our infrastructure and invest in our infrastructure. That is coming down fairly significantly from '08 to '09. It was originally our plan to do that and that's going to be delivered on.

Then the second piece is the CapEx is really around revenue generation. That really comes from leasing business as well as the EDS or the outsourced services business. So as that grows, it basically takes away from free cash flow, it is in fact the right thing to do because it is an indication that things are going well and we are going to have future revenue growth in that space.

So again, I get excited if -- I get excited and I think you should get excited when we see that piece grow.

There is another piece in '09 that is one-time in nature. There's a certain amount of CapEx related to the integration of EDS and basically getting EDS internal IP into our fixed next-generation datacenters. So, there is a little bit there from that perspective as well.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Given the expectations for strong cash flow this year, can you talk a little bit about uses of cash for acquisitions, share buybacks, dividends, etc.?

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

So we are consistent on our capital allocation priorities. Our number one priority is to invest in the business, and that's either organically or inorganically. Again, I put that as kind of the number one priority. Then the priority of little ways down the list is basically share repurchase, and further down is dividends. So we are basically returning cash to shareholders. You'll continue to see us be active in looking at different M&A targets. We've put that through our normal process, making for sure that it strategically makes sense, that it makes sense economically, and that we can operationalize it and integrate it as well as we've integrated the past acquisitions like EDS and like Compaq. Once we get through that filter, then that obviously -- it's an acquisition that we are really interested in.

From a share-repurchase perspective, we continue to do exactly what we've been doing, which is basically offsetting dilution that comes from employee benefit plans and then opportunistically buying a bit more.

David Bailey - *Goldman Sachs - Analyst/Moderator*

In the past, when you set revenue targets, you've been relatively conservative and then matched the OpEx to those lower revenue targets, allowing for a fair amount of leverage if there is revenue upside. Did you employ that same sort of philosophy as you were giving the targets this time around, or has it changed because the economic environment has changed?

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

There's no change. We continue to manage our business prudently and set our cost structure in line with what we think the revenue can do on a very conservative basis.

We also are very much focused continuing on improving our cost structure, so there's been no change there as well. A lot of the cost structure moves that we've made are structural, as I mentioned earlier, in that therefore they are there for the long-term and set us up very well for the future when the economies turn around.

David Bailey - *Goldman Sachs - Analyst/Moderator*

You said you've modeled for basically no economic improvement for the next few quarters. Is that including seasonality, excluding seasonality? Can you give a little more color around that comment?

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

So on our earnings call, we did say that kind of what we are modeling from a revenue perspective is that Q1 kind of persists through the rest of the year. Given kind of the macro environment, the changes in the channel inventory positions that we've talked about, as well as the cost savings initiatives that we've got underway, we don't think that the normal seasonality, especially in Q2 and Q3, is going to be a strong predictor of what we're going to do in those quarters.

In Q4, we did look at -- we modeled in more of a normal seasonality uptick from Q3.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Moving onto EDS, you recently said the integration is ahead of schedule. Is that more of a cost comment or is there more that it's actually working better than you expected?

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

It's a broader comment. In order to do an integration of the size of EDS, we have a lot of work streams. Those work streams are at or ahead of plan. In total, we are ahead of plan.

On the earnings call, we talked about the fact that, to date, we've got over 9000 of the headcount taken out already, which is ahead of plan.

The other piece that's a little bit ahead of plan is that, when we looked at kind of what the rehire need was going to be in 24,700 folks that we were going to -- or jobs that we were going to eliminate, we are going to rehire some offshore -- we were actually very pleasantly surprised by the fact that there's more capacity offshore. So we have not had to rehire as much, which means, over the long term, there will be a greater savings from EDS than what we had originally anticipated.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Okay. One of the goals of the acquisition was to drive other revenue from HP through EDS. Have you seen any of that yet, or when should we start to see that?

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

So what we are really seeing now is an uptick in the funnel and the interest. It's not really showing up, in any material way, in revenue, but there's still a lot of work that's being done there. The funnel being built, and we are pleased with, frankly, the customer reaction, both to EDS broadly as well as to the opportunities to pull through.

The customer retention with EDS has been good, better than we planned. Frankly, the customers' interest in working with us has been very positive, and so we are building a solid funnel, both on the outsourced services and application development side as well as on the pull-through of the hardware.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Now, HP has definitely become more aggressive with the cost-cutting, given the demand environment. Does this acceleration come at the expense of cost cuts that you might have had a year from now, or are those still out there?

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

They are still out there. If we could move faster, we would have already done that, so we are not holding back on anybody. The cost cut, we're moving as fast as we can to get the costs out of the organization.

We've got the services. We've talked a lot about (inaudible) every segment has a series of cost initiatives that they're working on, and they are in different stages. But if you look at services, we've talked a lot about kind of the three phases of the services cost initiatives around getting people in the right location, in the lowest-cost location so that we can still deliver the customer satisfaction that our customers demand; then looking at the processes that are in those locations and optimizing and standardizing them so that ultimately we can automate as much of them as possible so that you don't have to scale your revenue -- so you scale your costs with your revenue. That's probably in, I don't know, we are roughly halfway there on the services side. So we see that; we saw that in Q1 with the 50 basis point improvement in operating profit, even though we added in EDS that has a lower operating profit margin in services. We will continue to see that through '09 and '10 and into '11.

IPG has a number of initiatives that are longer-term in nature, and so they are working through those pieces.

From an IT perspective, we still have a full -- we haven't seen the full year's run-rate savings yet. We will see that in 2009.

Real estate still is out there in 2010. So, there's a lot of structural cost savings that are still yet to come.

The stuff that we've really done in the short term have been more short-term in nature, in terms of kind of I don't think we pulled in any really structural savings. We just did a lot of belt-tightening and, frankly, variablizing our cost structure with the moves that we made to reduce salaries and to convert that to more of a bonus opportunity for folks so that, if we perform well and meet our objectives, that won't drop to the bottom line; that will just show up in a more variable bonus to employees. What that gives us is a lot of flexibility, a lot of cushion and hedge in the earnings to adjust to whatever the demand environment looks like for the next three or four quarters.

David Bailey - *Goldman Sachs - Analyst/Moderator*

I think we are running out of time, so do you have a closing comment you would like to make?

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

I would. I'd like to wrap up the discussion by just leaving you with kind of three key points. The first one is that we are taking advantage of this downturn to optimize our market share, our margins, and our cost torture. You saw that; you saw some of that in Q1.

We are also -- I'm very confident in the earnings goals that we laid out for you in the earnings call last week and confident that we will generate strong cash flow in 2009.

Then finally, we are going to come out of this tough economy in a much better position, a stronger position. We've got great market positions today; we are gaining share. We're going to have a cost structure that is lean so that we will be able to get significant earnings expansion when things turn around, as well as strong cash-flow generation. So I think that we are very well-positioned.

David Bailey - *Goldman Sachs - Analyst/Moderator*

Great. Thank you very much. The breakout starts now or in five minutes in Golden Gate B2, which is up the escalator and to the left. Thank you very much.

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

Thank you very much.
