Hewlett Packard Enterprise

First Quarter Fiscal Year 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator
Good afternoon, and welcome to the First Quarter Fiscal Year 2018 Hewlett Packard Enterprise Earnings Conference Call. My name is Denise, and I will be your conference moderator for today's call. At this time, all participants will be in listen-only mode. We will be facilitating a question and answer session towards the end of the conference. Should you need assistance during the call, please signal a conference specialist by pressing the "*" key followed by "0." As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the presentation over to your host for today's call, Mr. Andrew Simanek, Head of Investor Relations. Please proceed.

Andrew Simanek
Good afternoon. I am Andy Simanek, Head of Investor Relations for Hewlett Packard Enterprise. I would like to welcome you to our fiscal 2018 first quarter earnings conference call with Antonio Neri, HPE's President and Chief Executive Officer and Tim Stonesifer, HPE's Executive Vice President and Chief Financial Officer.

Before handing the call over to Antonio, let me remind you that this call is being webcast. A replay of the webcast will be made available shortly after the call for approximately one year. We posted the press release and the slide presentation accompanying today's earnings release on our HPE Investor Relations webpage at investors.hpe.com.

As always, elements of this presentation are forward-looking and are based on our best view of the world and our businesses as we see them today. For more detailed information, please see the disclaimers on the earnings materials relating to forward-looking statements that involve risks, uncertainties and assumptions.

For a discussion of some of these of risks, uncertainties and assumptions please refer to HPE's filings with the SEC, including its most recent Form 10-K. HPE assumes no obligation and does not intend to update any such forward-looking statements. We also note that the financial information discussed on this call reflects estimates based on information available at this time and could differ materially from the amounts ultimately reported in HPE's quarterly report on Form 10-Q for the fiscal quarter ended January 31, 2018.

Finally, for financial information that has been expressed on a non-GAAP basis, we have provided reconciliations to the comparable GAAP information on our website. Please refer to the tables and slide presentation accompanying today's earnings release on our website for details.

With that, let me turn the call over to Antonio.

Antonio Neri
Thanks, Andy. And thanks to everyone for joining us on the call today. As you all know, February 1st marked my first day as the CEO of Hewlett Packard Enterprise. As a 23-years veteran of the company, I am honored to take on this role and excited about the opportunities ahead. Many of those opportunities exist, thanks to Meg Whitman's tremendous leadership during the past six and a half years. Meg set us on the current path and together we developed a strategy to take this company well into the future. I look forward to executing on that plan, and I am very grateful that Meg remains on our board.

Our strong Q1 performance is proof that we have the right strategy and improved execution. We have good revenue growth across every business segment, continued to execute HPE Next with no disruption to the business, and delivered strong shareholder return in the form of share repurchases and dividends.

Overall revenue of $7.7 billion was up 11% from the prior year, driven by growth across each of our business segments. From a macro perspective, we are seeing some improvement in market conditions and higher average unit prices, as pricing catches up to increases in DRAM costs.

In addition, we have strengthened our execution across a number of fronts and are driving better attach on our core industry standard server business. While we don't expect these rates of growth to continue given tougher compares in the second half of the year, the go-to-market changes we have made in our current portfolio mix have put us in a strong position. I will talk more about the business segment performance in a minute.

From an overall profitability perspective, we are making great progress on HPE Next, which is running cost savings as planned. The actions we have taken are helping us offset the continued margin impact from elevated DRAM cost and competitive pricing pressure. Overall, non-GAAP operating margin for the quarter was 7.7%. And we remain on track to achieve our fiscal year '18 margin outlook of approximately 9.5%.

Looking forward, we expect HPE Next to deliver the results we laid out in October. We have completed several critical parts of the program, including the sales force transformation, which significantly reduce the spans and layers between the CEO and the front line and streamlined the number of sales compensation plans. The fact that we were able to deliver the results we did in Q1 is evidence of our ability to execute HPE Next without disrupting the business.

In addition to our strong revenue performance and continued cost discipline, we have a number of several one-time items that impacted our EPS, including benefits from tax reform. Tim will provide the details on those in a minute.

With all that in mind, we delivered non-GAAP EPS of $0.34, which is $0.12 above the midpoint of our previously provided outlook. As a result of our performance in Q1, as well as continued benefits from a lower tax rate, we are raising our fiscal year '18 non-GAAP EPS outlook to $1.35 to $1.45 from our previously provided outlook of $1.15 to $1.25. In addition, given the tax reform, which provide easier access to offshore cash, we are increasing our shareholders return commitment and our investment in our employees.

From a capital allocation perspective, we now plan to deploy the excess cash on our balance sheet, and expect to return $7 billion to shareholders in the form of share repurchases and dividends by the end of fiscal year '19. This includes a 50% increase in our dividend, beginning in the third quarter of this fiscal year.

Tim will provide more details on capital allocation in a minute, but I remain committed to following the same rigorous disciplined ROI-based approach you saw under Meg's leadership. We also plan to take advantage of tax reform to increase our investment in our employees, by significant increase in the company 401(k) margin contribution and creating new degree assistance programs to encourage development and learning.

Now, I will give some additional color on our performance in the quarter. As you know, we have defined our strategy, built our portfolio based on the market disruptions we all are experiencing, driven by the digital transformation and the resulting explosion of applications and data.

At HP, we help our customers to extract critical insights from their data to accelerate business outcomes. We enable our customers to harvest, store and analyze the critical data that improves customer experiences, drive new business models and increases employee productivity.

HPE strategy is to help customer drive business outcomes by leveraging their data from the Edge to Core to Cloud, through our three strategic pillars. We power intelligent Edge, we make hibernating simple, and we use our services expertise to accelerate successful business outcomes for customers.

First, we power intelligent Edge. The Edge is the world outside the data center, and it is where digital transformation begins. It is where enterprises interact with their customers, where employees come together and where companies manufacture their products.

We are seeing a data power evolution happening at the Edge as customers leverage the unprecedented amount of data being created to drive their businesses. We have highly differentiated offerings in this space, including wireless LANs, network switching and converged Edge systems that bring together compute, storage, security and artificial intelligence, allowing customers to create truly intelligent Edge environments.

In the first quarter, we saw continued momentum in our intelligent Edge business, which grew 9% year-over-year with strengths in campus switching and services. In wireless access, we got off to a slow start in the quarter and faced a tough compare due to a large Home Depot deal in the prior year. We saw momentum pick up as we moved through the quarter and expect to return to growth with the help of our strong pipeline.

Given the significant opportunity we see, the intelligent Edge is the key area of investment for us and our innovation continues to be recognized in the market. For example, in January Aruba ClearPass was the first in the industry to be awarded common criteria certification by the national information assurance partnership.

Essentially, this validation provides the highest level of security certification an organization can achieve, and demonstrates Aruba's commitment to providing customers with the industry's most secure solutions for multivendor wire and Wi-Fi network infrastructures.

And we continue to win new customers. For example, in Q1, Wellington Management, one of the world's largest independent investment management firms, purchased mobility access switches and Aruba ClearPass for secure network access control. We also had the win for Aruba ClearPass with the US Air force Academy, and Royal Dutch Shell selected Aruba wireless LAN for the new wireless standard worldwide.

Next, I will turn to the second pillar of our strategy, Hybrid IT. We believe the world is becoming hybrid as each customer embraces their right mix of traditional IT, private cloud and public cloud environments. HP helps customers simplify this hybrid IT reality with secure software refined technologies and infrastructure solutions that are optimized to their specific workloads and data needs. Overall, hybrid IT revenue was up 10% year-over-year, driven by strong growth in compute, storage and datacenter networking.

In compute, revenue grew 11% year-over-year, driven by growth in core ISS, high performance compute, hyper converge and synergy. While we are seeing some market improvement in higher AUPs, we also executed well and seen positive customer momentum around the new secure software refined solutions we have brought to the market.

In storage, revenue grew 24% year-over-year, driven by the Nimble acquisition and improved 3PAR performance. As planned, we are seeing the positive impact from go-to-market changes we have made, particularly in the United States. And late last year, we rolled out HPE InfoSight across our entire converge and all-flash storage portfolio.

HPE InfoSight is a predictive analytics platform that uses software-defined intelligence to predict and prevent infrastructure problems before they happen. This product which came to HPE with Nimble is a game changer for our storage business and is a major step on our journey to an autonomous datacenter.

In datacenter networking, revenue grew 27% year-over-year, driven by strong execution within our installed base. Our differentiator in Hybrid IT is our software-defined services led approach which help customers navigate through the transformation challenges I talked about earlier.

Our Pointnext services organization is at the heart of that approach. It is also key to our customers' growing interest in alternative consumption models that give financial flexibility through pay-per-use alternatives enabled by our software innovation. I would talk about our newest offerings in this area in a minute.

In Q1, Pointnext revenue grew 2% year-over-year and orders were flat. We made progress on the initiatives we laid out during our security analyst meeting in October, including rationalizing the number of countries that we offer services in, in automating our core operations.

On the innovation front, we continue to introduce exciting new solutions that bring together services, software and hardware capabilities in a way that only HPE can.

For example, in December, we launched HPE GreenLake, a suite of pay-per-use solutions available for top customer workloads. Essentially, HPE GreenLake offer customers' choice in where workloads live and how to flexibly consume them. The offerings include Big Data, backup, open database, SAP HANA and Edge computing.

Also in December, we launched HPE OneSphere, a software management platform that lets customers deploy, operate and optimize on-premise private cloud environment and put the cloud capabilities through a simple unified experience. I believe that no one else in the market can match the platform we have created.

In November, we announced the world's most scalable and modular in-memory computing platform called HPE Superdome X. The platform enables enterprise of any size to process and analyze massive amounts of data and turn it into real time business insights. And we announced an innovative blockchain-as-a-service solution.

Enterprises are finding that the generic infrastructure in public cloud environments can now support the blockchain requirements that they need in terms of performance, security, scalability and resiliency. Our solution brings an enterprise grade capability to blockchain workloads. I believe our portfolio is the strongest we have had in years and customers are thinking of this.

For example, just this week, we announced a $57 million win with the Department of Defense for supercomputers, that it plans to use for tasks like designing helicopters and weather forecasting.

Eni, the multinational oil and gas company, recently announced the industry's most powerful supercomputer, the HPC4 based on HPE's ProLiant servers. And as some of you know, I am a big soccer fan. So I love that HPE's network and storage solutions are enabling Ajax [ph.], a professional football club in the Netherlands, to analyze player performance in real time through artificial intelligence.

So overall, the year is off to a slow start. I believe Q1 is a solid proof point that shows we are doing the right things. But there is still more work to do. We remain focused on executing our strategy, driving HPE Next and continue to introduce innovative products and services our customers are looking for. As long as, we sustain that approach, I am confident we will continue to deliver solid financial results and shareholder returns.

And now, let me hand the call over to Tim who will provide additional details on the quarter.

Tim Stonesifer
Thanks, Antonio. Q1 was a good start to the year with accelerated revenue growth, solid operating margins and better than expected earnings. Our results give me confidence that we've been making the right moves with our go-to-market changes, operational refinements and cost cutting actions to deliver strong shareholders value.

Total revenue for the quarter was $7.7 billion, up 11% year-over-year and 9% in constant currency. As Antonio discussed, top line performance was driven by combination of good execution, improving market dynamics a strong backlog entering the quarter and favorable year-over-year compares.

From a macro prospective, we continue to see a broadly improving IT spend environment from improved customer demand and higher AUPs. Competitive pricing and commodities remained significant year-over-year headwinds, but we did make encouraging traction regaining some of the ground we lost last year.

Exchange rates moved favorably throughout the quarter leading to a 180 basis point tailwind to revenue year-over-year. If current rates hold, we now expect currency to be a 3 point benefit to revenue in fiscal year 2018 versus the prior year.

By region, HPE's performance in the Americas continue to improve, growing 3% with strength in core compute and campus switching combined with a recovery in the organic storage results.

Revenue in Europe was even stronger, up 11% in constant currency, driven by an acceleration in core compute and storage with double-digit growth in Germany and Scandinavia. Asia Pacific grew almost 20% in constant currency, delivering solid core server revenue with double-digit growth in Japan, China and Australia.

Turning to margins, the gross margin of 28.4% was down 370 basis points year-over-year and 130 basis points sequentially. Non-GAAP operating profit of 7.7% was down 180 basis points year-over-year and 50 basis points sequentially.

We executed well this quarter and we are able to accelerate some incremental cost savings from HPE Next, but still have more work to do driving key improvements later in the year. We also delivered some additional operating leverage in Q1 associated with the strong revenue growth.

These two items help offset normal seasonality, as well as, those large year-over-year impact from DRAM which didn't spike until late January last year. We are still seeing some sequential increases but they are moderating, the pricing environment remains challenging but it is showing signs of improvement with more ability to pass cost increases through to customers.

Non-GAAP diluted net earnings per share of $0.34 is considerably above our previous outlook of $0.20 to $0.24 due to a few factors.

First, we benefited by approximately $0.03 from a lower tax rate associated with tax reform that we will discuss in more detail shortly.

Second, our other income and expense was about $0.04 better than expected, primarily due to foreign exchange favorability related to our balance sheet hedging program.

The remainder of the out performance was driven by the strong revenue growth and acceleration of some HPE Next cost savings.

Non-GAAP diluted net earnings per share primarily excludes pre-tax amounts for tax indemnification adjustments of $919 million, transformation and restructuring charges of $248 million and amortization of intangible assets of $78 million, offset by income tax adjustments, including tax reform of $2.2 billion.

GAAP diluted net earnings per share was $0.89 above our previously provided outlook range of $0.01 to $0.05, due primarily to non-cash income tax benefits associated with tax reform and adjustments to prior valuation allowances from our fiscal year '17 separation activities.

Before I discuss the results by business; I wanted to remind everyone that we will be reporting fiscal year '18 results in three primary segments. Hybrid IT, which includes compute, storage, datacenter networking and Pointnext, Intelligent Edge which includes campus and branch switching, wireless LAN, Edge compute and Aruba services, and lastly, financial services. This new structure more accurately reflects how we go-to-market and manage the business internally.

Besides modifying the reported segments we also transferred costs including stock compensation expense from corporate investments and corporate unallocated and to the other reported business segments to better align reporting with how the businesses are evaluated for performance. Hopefully, you saw the 8-K we filed last week which included reconciliation tables to restate fiscal year '16 and fiscal year '17 results into the new reporting structure.

Now turning to the results by business; in hybrid IT, revenue was up 10% year-over-year and 9% in constant currency with growth across all businesses and all regions. Operating margins were down 310 basis points year-over-year and 20 basis points sequentially to 9.6% in line with our expectations. The sequential margin decline is a result of normal seasonality offset by HPE Next cost savings and operating leverage from revenue growth.

Compute revenue was up 11% year-over-year and 14% excluding tier 1. We executed well on our core server business driving 16% growth as richer attach configurations and elevated commodity costs continue to drive AUPs higher. We saw continued momentum in our value businesses with high performance compute growing low double-digits and synergy up over 40% sequentially. Growth in hyper converged with SimpliVity continued at over 200% year-over-year.

Storage revenue was up 24%, driven by the Nimble acquisition and strong recovery in the organic business which grew 11%. 3PAR returned to growth driven by significantly improved performance in the Americas, as we saw the benefit from the go-to-market and leadership changes we made last quarter. We also saw strong double-digit growth in Big Data storage, which has been a growth driver over the last five quarters. All-flash arrays grew 16% year-over-year. We also expect to take back some share in total external disk.

Datacenter networking revenue was up 27% and continues to reform very well with good sales execution. Pointnext revenue was up 2% with operational growth for the sixth consecutive quarter.

Overall, orders were flat as growth in our attach business, driven by higher services intensity more than offset hardware unit declines. However, our install base orders were down due to a push out of a few deals into the next quarter that have since closed and some weakness in renewals from ongoing declines in legacy business.

In the Intelligent Edge, revenue was up 9% year-over-year and 7% in constant currency. Operating margins were up 10 basis points year-over-year and down 960 basis points sequentially to 2.9%. While the rate was impacted by lower wireless sales in Q1, we are also managing the business for accelerated growth and share gains. Aligned to our strategy of pivoting to the Intelligent Edge, we have been making significant R&D and go-to-market investments that have given us a leadership position in this high growth market opportunity.

Aruba product grew 9% with strong growth in campus switching that continues to benefit from pull-through with the Aruba acquisition. Wireless LAN results were disappointing due to a slow start and a tough compare given the major wins in the first quarter of fiscal year '17. However, we have a strong pipeline and are confident revenue will rebound quickly. Aruba services was up 6% as we continue to improve services attach with the goal of driving rates closer to those in Pointnext.

HPE Financial Services revenue grew 8% year-over-year and 5% in constant-currency, driven by strong residual sales and improving direct business. Financing volume was up 7% as solid growth in our direct business was offset somewhat by declines in our indirect business. Operating profit declined 110 basis points year-over-year to 8.1% due to an unfavorable compare with the bad debt reserve release in the prior year period.

Now turning to cash flow, free cash flow was negative $412 million and in line with expectations. The cash conversion cycle increased six days sequentially to negative 21 days, driven primarily by purchasing linearity. We returned $862 million to shareholders during the quarter, including $120 million of dividend payments and $742 million of share repurchases. We also ended the quarter with an operating company net cash balance of $4.3 billion.

Before I move to the outlook, I wanted to provide some more details on how tax reform will impact HPE and the updates to our capital strategy that Antonio previously mentioned. Overall,

the recently passed tax reform makes us more competitive with foreign peers and provides greater cash management flexibility. As you saw this quarter, we had several GAAP only non-cash items related to tax reform, which included adjustments to deferred tax assets and liabilities plus transition tax expense that we expect to offset with tax attributes.

From a non-GAAP perspective, given that our fiscal year '18 began before the end of the calendar year, we're not subject to the new foreign minimum tax for fiscal year '18. Therefore, we expect our fiscal year '18 tax rate to be 11% to 15%. Beginning in fiscal year '19, we will be subject to the foreign minimum tax and expect our non-GAAP tax rate to be 16% to 20%.

Tax reform has also given us increased access to our cash balances offshore, enabling more financial flexibility. As Antonio discussed, we plan to deploy our excess cash and expect to return $7 billion to shareholders in the form of share repurchases and dividends between fiscal year '18 and fiscal year '19. This will include a 50% increase in our quarterly dividend to $0.1125 per share, starting in Q3 of this year from our current $0.0750, as well as share repurchases of over $5.5 billion by the end of fiscal year '19.

The buyback will be more weighted to fiscal year '18 but we will repurchase shares in an efficient manner so that timing may not be linear. As always, we will continue to use our ROI-based capital allocation framework. While this is currently biased to capital returns, retaining our existing investment grade credit rating is important and we'll also continue to take a disciplined approach to M&A.

Now turning to our outlook. We're increasing our non-GAAP earnings outlook for fiscal year '18 by $0.20 based on several factors.

First, we'll see a significant benefit from a lower tax rate associated with tax reform.

Second, given the Q1 benefit from our balance sheet hedging program and ongoing drop in hedge costs due to rising US interest rates, we now expect OI need to be only $200 million expense in fiscal year '18 versus $300 million previously guided at our Analyst Day.

Third, we expect some minor benefit for incremental share repurchases that will likely be done towards the end of the year.

Lastly, we are passing through the operational outperformance in Q1 that will be somewhat offset by the incremental investments in our employees that Antonio mentioned.

As a result, we expect fiscal year '18 non-GAAP diluted net earnings per share of $1.35 to $1.45 and we also expect GAAP diluted net earnings per share to be $1.35 to $1.45.

For Q2 '18, we expect non-GAAP diluted net earnings per share of $0.29 to $0.33 and we expect GAAP diluted net earnings per share to be $0.10 to $0.14. We also continue to expect free cash flow of approximately $1 billion in fiscal year '18. So overall, like Antonio, I'm very pleased with performance this quarter, and I'm looking forward to executing the remainder of the year.

So with that, let’s open it up for questions.

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question and answer session. To ask a question, you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys, to withdraw your question, please press "*" then "2." We also request that you only ask one question and one follow-up question.

The first question will be from Katy Huberty of Morgan Stanley. Please go ahead.

Katy Huberty
Thank you. Congrats on a great quarter. The guidance implies that you don't think the strength in server and storage were the upside in server and storage that you saw this quarter continues into future quarters. So I just wonder whether you can comment on whether there were some one-time benefits from the manufacturing transition, catch-up in execution around the storage sales force. What are some of the one-time benefits that you think helped in fiscal 1Q and that suggest to you that that strength will necessarily continue later into the year? And then I have a follow-up.

Tim Stonesifer
Sure Katy. Let me start off and then I'll pass it over to Antonio. So if you look at that 11% growth, I would say 4 points of that is related to foreign exchange and acquisitions, and the timing of the acquisition if you think about Nimble and SimpliVity. There's probably about all of this is always hard to measure, 4 to 5 points of better market and backlog, we did go into Q1 with a stronger backlog than what we typically have. And then I'd say there's probably 2 to 3 points that's related to execution. So those are sort of the drivers for Q1.

As you think about the total year, I just ask you to think about two things. First of all, particularly in the back half of the year, as you recall last year, we had a big ramp in revenue in the back half of '17. So as we get into '18, that's going to be a tough compare. And then the other thing to take into account is backlogs will normalize and as they return to more normalized levels that will have an impact as well. Antonio...

Antonio Neri
Yes, sure. Thanks for the question. I will just only add that as we progress throughout the year, right, obviously the AUPs will be more normalized because of the DRAM cost and the pricing they're going to be more kind of in line compared to the Q1, because the Q1 last year was DRAM had no impact to pricing. So that's one of factors we need to consider in. But as Tim said, obviously we have a tougher compare but our focus is really on the volume to value, to growth execution. On the volume side of the equation, we continue to focus on profitable share and obviously improve that cost structure. And on the value on the pockets of growth we discussed before, particularly around hyper converge, high performance compute and ramp of synergy.

Katy Huberty
And then just as a follow up when you consider the $7 billion of capital return, how do you think about that in terms of whether it limits you from doing multibillion dollar M&A deals or are you willing to take the business into a net debt position if the right deal comes along?

Antonio Neri
Yes, I know, I'm very committed to apply the same rigorous disciplined ROI-based approach that Meg laid out in her tenure here. And obviously right now we are obviously biased to share repurchases and increasing dividends. We talked about M&A before, but I would like to emphasize our focus on innovation. Innovation is three-step approach; one is our organic innovation where we obviously want to invest our own dollars there; second is through the partnerships and the focus on emerging technologies where we can invest small amount of dollars in this disrupting kind of technologies and companies that we can bring in our ecosystems and shine them through our solutions in the go-to-market we have. And then last but not least, is the M&A, if there is an opportunity with the right valuation, the right appeal, the right talent, we will obviously consider it. But I think we have enough flexibility in our financials to go do that. And let's remind ourselves when we talk about what the acquisition looks like, the Aruba likes or even smaller than that. So that's our focus. But right now, we are really committed to that ROI-based capital allocation.

Katy Huberty
Thank you.

Andrew Simanek
Thank you. Could we have the next question, please?

Operator
The next question will be from Toni Sacconaghi of Bernstein. Please go ahead.

Toni Sacconaghi
Yes, thank you. I just wanted to clarify your guidance raise, so you beat by $0.12 this quarter. The lower tax rate should add $0.10 and the lower I&E...and that's $0.10 starting in Q2 and not counting the lower tax rate in Q1, so not double counting. And then the better than previously guided OI&E would add $0.05. So just those three factors alone would add $0.27 to your EPS and yet you’re raising your guidance by $0.20. Should we be reading into that that you are making incremental investments or that’s something that’s weaker than you had expected?

Tim Stonesifer
Yes, Toni. You had me up until the $0.27, so let me just take you through how we think about it. You are right, the tax rate I think about the $0.03 benefit that we had in Q1 that should carry forward, so call that $0.12. The OI&E benefit is roughly $0.04. If you think about what the incremental share buybacks, those will probably be backend loaded given the fact that we had already frontend loaded our previous commitment, so that maybe a penny or two. And then we’re flowing through the Q1 operational improvement of $0.04 to $0.05 with the exception of the fact that we did accelerate or see some accelerated savings from HPE Next and then obviously, we need to fund the investments in the 401(k) and the employee programs that Antonio spoke about. So that's how I think about the $0.20 raise, which we think is prudent at this point in time.

Toni Sacconaghi
Okay. And then can you comment on what your outlook for free cash flow is for the year? I think your previous guidance have been $1 billion, I'm not sure if I missed it or whether you've reaffirmed that?

Tim Stonesifer
Yes, we did reaffirm the $1 billion, again, if you think about the $0.20 increase that I just walked through, more than half of that is tax driven. And as you know our cash tax rate is lower than our effective tax rate, even with the revision it will be so in that same range from a cash tax perspective, so no real benefit there. We should see some upside in the OI&E and the operational performance, but given the fact that it's only Q1 and that there is still a lot of work to do, we felt it was prudent to stick with the approximately $1 billion that we talked about at the security analyst meeting.

Toni Sacconaghi
Thank you.

Andrew Simanek
Okay. Thanks, Toni. Can we move on to the next question, please?

Operator
The next question will be from Sherri Scribner of Deutsche Bank. Please go ahead.

Sherri Scribner
Hi, thank you. You guys saw a very strong growth this quarter, and clearly you benefitted from an easy compare versus last year. I think at your Analyst Day, you had guided to growth this year. I guess, I am trying to understand how you think about growth as we move through the year? And I think you had commented that your long term growth outlook for the business is something like 0% to 1%. Is that still the right way to think about your opportunity to seek growth for the business?

Antonio Neri
Yes, thanks Sherri for the question. So we obviously are committed to the financial architecture we laid out in October at the Security Analyst Meeting. Again, let's go back to the Q1 growth. Again, a lot of that was obviously…the AUP increases we see…we saw in the market because of the pricing increasing but also strong execution. I think when I think about the Q1 results is a proof point of we have the right strategy and focus.

I think, we have to see what the pricing environment is going to do. But overall, I think our focus is really to be with the portfolio from the volume side of the house to the value side of the house, which obviously the growth rates are very different. And…but, as we look through the year, right, we are going to lap bigger numbers. And as I said earlier, right, the AUPs are going to be more in line to the cost increases we saw last year. So we don't expect that lift on the pricing we saw at the beginning of this year.

Sherri Scribner
Okay, thanks. And then maybe a question for Tim, thinking about the margins, you guys beat a little bit on operating margin line this quarter, but you maintained the full year outlook for operating margins of 9.5%. How should we think about margins trending as we move through the year, I assume this quarter is going to be the low point?

Tim Stonesifer
Yes, this quarter will be the low point as we talked about at SAM. We did see a little bit of favorability again, you know, we had some benefit that we pulled forward on the HPE Next savings. But our plan is going to be back half loaded and the reason that is, is because if you think about HPE Next, we are being very thoughtful and deliberate as to how we execute those

simplification actions, because we want to minimize the business disruption. I think Q1 and the revenue performance we saw there was a good proof point.

Secondly, the recent acquisitions we've done, those become more accretive throughout the course of the year as we continue to grow those businesses and right size the cost envelopes. And then we should see a mix lift. And as we continue to grow the higher margin parts of the portfolio, whether it would be hyper converge, all-flash array et cetera, we should get a natural mix lift. So Q1 will be a low point and then we'll continue to expand margins throughout the course of the year.

Sherri Scribner
Thank you.

Andrew Simanek
Great. Thank you, Sherri. Next question, please?

Operator
The next question will be from Jim Suva of Citigroup. Please go ahead.

Jim Suva
Thank you very much. In your prepared comments, you talked about strength in the sales, which, of course, is helped by easier costs. Then you also commented on strong margins, but when we look at the margins, if my math is right, it looks like they actually declined like a 180 basis points and it was kind of across most of your segments, yet sales did increase a lot. So can you help us bridge the gap, I am sure memory prices are large part of it or is it all the part, help us bridge the gap about why you didn't see some positive margin leverage despite the sales increase year-over-year?

Tim Stonesifer
Yes, I am not sure we said strong margin, we saw a strong revenue performance. To your point, we did see margin pressure and that's primarily driven by DRAM. So again, if you think about it, in Q1 of ’18, we have a full quarter of elevated DRAM costs because those costs do not spike until January of ’17, so that’s a pressure point. We are also seeing a little bit of mix pressure in Q1 given the strong performance in high performance compute so that obviously has a lower margin as compared to Edge and Pointnext, and that’s being offset by some of the cost savings. So we are seeing margins pressure to your point. But again, margins will expand throughout the course of the year.

Jim Suva
Okay. And then as my follow up, it seems like the DRAM memory cost would impact, if I am correct, both Hybrid IT and Intelligent Edge segments, if you can clarify that. But I struggle about why would financial services be down, operating margin so much despite their revenue growth?

Tim Stonesifer
Yes. Sure, so the operating margins and financial services that’s primarily driven by a onetime bad debt reserve benefit that we had in Q1 of ‘17 that doesn’t repeat in Q1 of ’18.

Antonio Neri
And I will say on the DRAM since you have the part of the question there actually everything is in Hybrid IT. There is very little that impacts the compute Edge, but I will say the most if not all of that is in the Hybrid IT.

Jim Suva
Great. Thank you so much for the clarity. It's greatly appreciated.

Andrew Simanek
Thanks, Jim. Next question, please?

Operator
The next question will be from Steve Milunovich of UBS. Please go ahead.

Steve Milunovich
Thank you very much. Could you remind us about the cost savings from the HPE Next program this year and going forward, and how much you pulled into the first quarter relative to your expectations?

Tim Stonesifer
Sure. So for 2018, we have about $250 million of net cost savings related to HPE Next. I would say probably a third of that is front end loaded in the first half and then the remainder is back end loaded. And then for the total program, because again this is a three year program, we should net about $750 million to $800 million of net cost savings.

Steve Milunovich
Great, thank you. And as you go through the share repurchase and dividend increase, where do you expect to come out in terms of net cash position. Are you going to be in a net cash position or will it be net debt on the core business?

Tim Stonesifer
So for this year, we will end up in a net cash position, over the long-term, if you think about '19 and beyond, again from a net cash position we should be neutral, may be a little bit positive, but it will take us some time to work through that.

Steve Milunovich
Great, thank you.

Antonio Neri
And are there…thank you.

Operator
The next question will be from Rod Hall of Goldman Sachs. Please go ahead.

Rod Hall
Yes hi, guys. Thanks for the question. I wanted to start off and ask about linearity and see if you could comment a little bit on the backlog exiting the quarter, given you came into the quarter with high backlog. Did you exit with high backlog as well? And then I have a follow-up.

Antonio Neri
Sure. No, listen I think we had strong execution. We continue to build a strong momentum and pipeline, and we exit slightly above where we normally expect by the end of the quarter. So we feel good about how we exited and most important about our pipeline.

Rod Hall
Okay, great. Thanks Antonio. And then I wanted to just ask a broader question. Did you see acceleration at the end of the quarter after the tax bill passed? And do you believe that your customers have fully reacted to the tax saves or do you think people are still out there planning what they might be able to spend as they go forward?

Antonio Neri
Well, I think it's too early to say or to call it. I will say, our Q1, performance was steady, was consistent throughout the quarter, except the wireless comment we made earlier where we started slow and finished strong. But in Hybrid IT, it was very consistent across all the businesses. And part of that is because obviously we have phenomenal innovation that customers are liking. Last week, I was actually in UK and I hosted a board of advisor where we bring our key strategic customers to talk about vision, our strategy, get their inputs about the future. And they all made the same comment. We love your innovation. We need you to continue to position that innovation against our problems and they see the value of that. So we never had the position we have today in terms of portfolio, and with the simplification of sales, remember we eliminated the regional layers. We eliminated people in the middle between me and the country. Actually, we believe that's helping us to accelerate the execution we talked early on.

Rod Hall
Great. Okay, thank you.

Andrew Simanek
Thanks Rod. Can we move to the next question, please?

Operator
The next questioner will be Shannon Cross of Cross Research. Please go ahead.

Shannon Cross
Thank you very much for taking my question. Antonio, can you talk a bit about what you've learned from HPE Next because it's going through the business and the model? I am curious as to response from your employees currently it's not really impacting front-facing employees because the revenue is coming through. But I am curious is it in line with your expectations are you finding more areas to cut over time? And then I have a follow-up. Thank you.

Antonio Neri
Sure. So first of all, let me remind what the HPE Next is all about, right. So HPE Next is the initiative I launched which I architected last year around [indiscernible]. And it's all about simplification, innovation and execution. And I have to say, I am pleased with the first quarter performance where we executed well with no disruption. But this is an opportunity for me as the new CEO to establish a new culture as we transform the company and to really architect the company from the grounds up with a clean sheet approach. And this is going to change the culture of the company. What I learnt is the fact that you can push more, you can do more. And the organization is actually very excited about what we are doing because they see an opportunity to improve the way serve our customers. So it is very critical initiative for us and we

are confident we are going to deliver not only the improvements in our cost savings, but also the way we work and employee productivity. And most importantly that should reflect in our business performance and our customer satisfaction.

Shannon Cross
Okay. And then can you provide more details about the incremental investments you are making in your employees that you talked about, with regard to the tax reform? Maybe some more specifics on what you are going to be investing? Thank you.

Antonio Neri
Yes. So in my prepared remarks and as Tim said, we are investing in two specific areas. One is in the 401(k) matching contribution. So we are raising that significantly. And we believe that's a more structural approach that will benefit our employees versus paying a one-time bonus, I think that's a long-term benefit for our employees.

And second is, let's say we live in a market that moves so rapidly and the need to rescale our workforce has never been higher. So the ability to provide assistance kind of learning to whatever degrees we want to put our employees through it, I think is a great investment for the future of the company and our employees. So they can fulfill their visions in our company as they progress with their career.

Andrew Simanek
Great. Thank you, Shannon. Can we move on to the next question, please?

Operator
The next question will be from Lou Miscioscia of Pivotal Research. Please go ahead.

Lou Miscioscia
Okay, great. Can you go into little bit more detail on the storage side. It just seems that 3PAR bounced back so much faster than we had expected, and then also maybe just tie into that, what are you seeing on a quarter-to-quarter basis for pricing for DRAM and NAND?

Antonio Neri
Sure. Listen, this was a good quarter for us, in storage. We grew the business 24% year-over-year and in that obviously have the Nimble numbers. But as Tim and I stated in our prepared remarks, our organic storage grew 11%. And as we talked in the previous two calls, we talked about some of the execution challenges we had in our go to market, particularly in the United States. And one of the comments we've made in one of those calls is that we brought together the storage sales force from Nimble and 3PAR together under the leadership of an individual called Keegan Riley, which has tremendous expertise. And we see now the benefits of that. When you go out to the market with a clear value proposition and a differentiated offering, it starts paying off. So this was all about focus and execution.

However, at the same time, we continue to bring great innovation. And so starting this quarter, we brought out the HPE InfoSight that came with the Nimble acquisition. And now we…and as you know, InfoSight these days what we call AI or the autonomous technologies in the datacenter with predictive and preventative kind of technologies and algorithms, now we made that available to the entire converged storage portfolio for Nimble, 3PAR and all-flash. So we believe we have a differentiated offering. We have a very focused sales force and we have a value proposition that I think customers are liking it.

Tim Stonesifer
I think maybe you want to hit on the DRAM question?

Antonio Neri
Yes, so on the DRAM question, listen, we continue to see some nominal increases in DRAM, but these are low single digits kind of cost increases. Starting this quarter, we have done a better job passing those increases to our pricing. And as the competitive market kind of normalizes a little bit and becomes most rational, we are able to pass those through. As I think about the remainder of 2018, we will continue to see some nominal increases but not obviously at the elevated levels we saw last year. And then we see what incremental supply will be available. As you know, there are transitions from 2D to 3D and new fabs that will be coming online, but it's all to be seen. So we factor in our plans the elevated RAM for the remainder of the year.

Lou Miscioscia
Great. Okay. Thank you.

Andrew Simanek
Thanks, Lou. Can we have the next question, please?

Operator
The next question will be from Ananda Baruah of Loop Capital. Please go ahead.

Ananda Baruah
Hi, good afternoon guys and congrats on a solid quarter. Antonio and Tim, I guess just circling back to the potential for long term growth in the context of…what the SAM guide was of 0% to 1%, I believe that what had been the headwind businesses, which were your Microsoft Tier 1 business and Unix have now bottomed out. And please correct me if that’s inaccurate. But if it is accurate, particularly what feels like a secular mix shift up in the Window's Server business, what would be the reason that you wouldn't be able to now grow greater than that longer term, and maybe even sort of some meaningful basis points, hundreds of basis points greater than that given that you’re pretty well positioned now in markets that are growing, and you've gotten some really good traction? Thanks.

Antonio Neri
Sure. Let me answer first the Tier-1 question. As we stated at SAM, we are totally deemphasizing the focus on what we call the customized commoditized compute platforms. That does not mean that we're going to continue to sell the rest of the portfolio to those large customers, because those are customers who buy everything, not just that type of platform with commoditization. So we are executing that strategy and we remain committed to that strategy, which obviously is a headwind because as you know that business was at a peak between 15% and 20% of our numbers. So that’s point number one.

Point number two, as I said earlier right, as we see the first half versus the second half, you see the inflated AUPs in terms of compares. As you go to the second half, that’s not going to be the case. And also we had…remember we had Nimble, now in the second half fully baked in our results of 2017 second half. And so that compare will be harder. That said, listen I am optimistic and confident about our ability to compete and win in the areas we decided to pay focus and attention. For example, high performance compute, hyper converged, synergy, which has been a great success for us. But remember, it plays 2 roles, one is what we call blades only better and the other one is the composable infrastructure, which allows us to bring that

public cloud experience on premises. And then we expect to see solid continued performance in storage. So I think the mix will play a huge role here as we go along the way, but that's why at this point in time, we are little bit more cautious about that.

Ananda Baruah
I got it, that's really helpful. It seems like you're well set up that being said, relative to the model. I really appreciate it, that's it from me. Thanks so much.

Andrew Simanek
Great. Thank you, Ananda. Next question, please?

Operator
The next question will be from Wamsi Mohan of Bank of America Merrill Lynch. Please go ahead.

Wamsi Mohan
Hi, thank you. Just a clarification, on your pull forward of HPE Next, is that just pull forward within the cost savings that you alluded to, that you would accomplish this year, or is the entire plan just tracking ahead and you can accomplish the entire HPE Next on a faster timeline?

Tim Stonesifer
Yes, that was really more of a Q2, Q3 into Q1. Again, we're early on an HPE Next. We're pleased with the progress, the teams are making tremendous progress, but it's still early and that's just a pull forward from Q2 or Q3.

Wamsi Mohan
Okay, thanks Tim. And then just as a follow-up. Could you give us some sense, I mean, Antonio, you mentioned this a few times about server configurations being beefier, your mix…HPC benefiting mix as well. Could you give us some sense of how server units trended on a year-on-year basis, just on to your XTier-1?

Antonio Neri
Sure, obviously. Listen, these configurations gets smarter and bigger. Just to give you an example, our standard pro LAN server now, which is the industry leading virtualized platform, called the ProLiant 380. You can actually configure all the way up to half petabyte in a very small form factor. So those are massive technological advancement, both from the commodity perspective, from the system design perspective. And so obviously customers are buying more rich configurations, because they were [indiscernible] also it's a question of economics in term of power consumption and performance. So that's one aspect.

In terms of what we expect for units, listen the vast majority of the unit growth has been in the what we call the hyper scaler, but we see growth obviously in HPC, right. These are very large cluster configurations. But at the same time, we see the growth in value normalized with the decline in enterprise, so it's hard to give you a number, it's going to come down to the mix. We believe the value units will continue to grow and the volume side of house will be a decline. And then, ultimately it's going to be mass exercise. But again, let me emphasize where our focus is, our focus is profitable share growth.

Wamsi Mohan
Thank you. Very helpful.

Andrew Simanek
Great. Thank you, Wamsi. I think we have time for one more question, please?

Operator
And that question will be from Amit Daryanani of RBC Capital Markets. Please go ahead.

Amit Daryanani
Thanks. I guess mainly to start on the compute side. Could you just talk about the 10% growth how much of that is units versus ASP for you guys. And broadly how do you think of the server market through fiscal '18? And is there a potential for a bigger refresh in the back half given all the security issues?

Antonio Neri
Sure. I will say the vast majority of the growth has been AUP driven. And I just I think provided some insight in the previous question where we expect some growth in units. But again, it's just the size view of that and a mix view of that. I think in terms of refresh, listen we're still early in what we call the Skylake refresh, that refresh has not been different than any other transition we have seen in the past, whether the spectra and meltdown issues, which are an industry wide issue.

Right now, we don't see any slowdown or any increase in demand. But as I think about the future and think about the performance impact that some of these patches could have on specific workloads, customer will have to think about how to cover that incremental capacity. And we at HPE have already made available services offerings. So from the service perspective, we can help customers manage those patches and upgrades and also product upgrades, modernization type of programs, as well as consumption based models with HPE GreenLake. So they can…let's say, they need a 10% more capacity, we can offer that 10% on their premises as pay as you go. And so all those programs have been rolled out to our field and to our channel partners and we're going to monitor that as we go along.

Amit Daryanani
Got it. If I can just follow-up quickly on the tax rate dynamic that you talked about, I'm curious is there any change to you cash tax rate at all in fiscal '18 or in fiscal '19. I realized what's happening on the P&L. But on the cash tax rate, does that change over the next few years?

Tim Stonesifer
No, it doesn't really change over the next few years. But longer term, our cash tax rate will probably be closer to our effective tax rate.

Amit Daryanani
Perfect. Thank you.

CONCLUSION

Andrew Simanek
Great. Thank you, Amit. And I think with that, we can close down the call. Thanks everyone for joining us today.

Operator
And ladies and gentlemen, the conference has concluded. Thank you for attending today's presentation. You may now disconnect your line.