Hewlett Packard Enterprise

First Quarter 2017 Earnings Conference Call

Thursday, February 23, 2017, 05:00 PM Eastern

CORPORATE PARTICIPANTS

Meg Whitman - *President and Chief Executive Officer*

Tim Stonesifer - *Executive Vice President and Chief Financial Officer*

Andy Simanek - *Head of Investor Relations*

PRESENTATION

Operator
Good afternoon and welcome to the First Quarter 2017 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 Andy Simanek, Head of Investor Relations. Please proceed.

Andy Simanek
Good afternoon. I'm Andy Simanek, head of investor relations for Hewlett Packard Enterprise. I'd like to welcome you to our fiscal 2017 first quarter earnings conference call with Meg Whitman, 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 Meg, 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 discussion of some of these 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, 2017.

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. Throughout this conference call, all revenue growth rates, unless noted otherwise are presented on a year-over-year basis and beginning with fiscal year 2016 are adjusted to exclude the impact of divestitures and currency.

We believe this approach helps provide a better representation of HPE's operational performance, given the significant divestitures we have recently completed, including the sale of Mphasis, 51% of our H3C business in China and TippingPoint amongst several others. Please refer to the table and slide presentation accompanying today's earnings release on the website for details.

With that, let me turn it over to Meg.

Meg Whitman
Good afternoon, everyone. Thank you for joining us on the call today. Let's dive right in.

Overall, as I look back on Q1, I would say our performance was mixed. I was very pleased with our non-GAAP net diluted EPS of $0.45, at the high end of our previously guided range. We delivered normalized free cash flow of $200 million, a $500 million improvement year-over-year. And we saw strong performance across key growth areas of the portfolio.

However, we also encountered some unexpected headwinds during the quarter. We saw several external factors impacting our performance that will become more challenging through the remainder of fiscal 2017, and we came up against some execution-related problems that we are now fixing. Let me talk a little bit more about the challenges we saw in the quarter and how we think about them.

First, we faced a significant challenge on both the top and bottom lines from foreign exchange rates, particularly the strengthening of the dollar versus the euro and the yen. We were able to largely address the impact on our profitability in Q1 with our hedging strategy. However, we expect the continued strength of the dollar as these hedges roll off to present a significant headwind for the remainder of the year.

Second, we saw an impact from a challenging industry wide commodities market, particularly tight NAND supply, which impacted sales in our storage and compute businesses, and elevated DRAM pricing. We were able to mitigate a portion of the impact in Q1 through procurement strategies. However, we expect that the increase in DRAM pricing will accelerate and create near-term challenges to our profitability.

Third, revenue was impacted by a tough market environment, particularly in core servers and storage. We saw significantly lower demand from one customer, a major tier 1 service provider facing a very competitive environment.

Finally, we experienced some execution issues in the Enterprise Group business. So, let me say a little bit more about that.

As you know, during the past few months we have been preparing HPE to compete aggressively following the spin mergers of ES and software. To that end, we have been making significant changes to our organization, all during the final intense months before the ES separation, and as the software separation got underway.

In just the last quarter, we have reshaped the entire Enterprise Group business to better drive the three pillars of our strategy; hybrid IT, the intelligent edge and services. We appointed a new global head of sales and new sales leads in each of our geographical regions. We hired a new leader for the Technology Services business and we hired a new leader for our channel program. These are just some of the more significant changes we've made to set the company up for long-term success.

While these changes were the right changes to make, it was a lot for the organization to take in. Frankly, as we headed into Q1, we overloaded many of our top people and disrupted the day-to-day cadence of our business more than we should have. The good news is that we've indentified the problem and are fixing it. More importantly, once the dust settles, the changes we have made will leave HPE in a much better position to compete and win.

Now, while we faced a number of headwinds in the quarter, we also continued to see positive momentum across a number of fronts. In the Enterprise Group, I was very pleased with our focus on the critical, higher margin, higher market growth areas of the portfolio that will be the foundation of our futures success. We delivered strong results in Technology Services Support and Consulting, Aruba, high-performance compute, and all-flash storage. And this focus drove improved year-over-year operating margins in EG, when adjusted for currency and divestitures.

We also made strong progress in Enterprise Services where we continued to shift headcount to lower cost locations and the operating margin came in at a solid 7%, within our long-term target range. And software continued to stabilize revenue and improved operating margins by 400 basis points.

At the same time, throughout Q1, we continued to execute strategic acquisitions, invest in innovation and develop important partnerships. All of these actions were directly aligned to the three pillars of our strategy, hybrid IT, the intelligent edge and services.

In our mission to make hybrid IT simple for our customers, we completed the acquisition of SimpliVity, a leading provider of software defined hyper-converged infrastructure. The hyper-converged market is approximately $2.4 billion, and it is growing around 25% annually. So we see this as a significant opportunity.

By bringing together HPE's simple user interface, developed for our HC 380 solution, with SimpliVity's enterprise class data fabric, HPE will deliver the industry's best and most comprehensive hyper-converged offering on the market. This world-class technology, combined with HPE's unmatched global go-to-market, is a game-changer in the hyper-converged space. We just closed the deal on Friday, and I am pleased that we received our first order on the same day. Customers can clearly see the promise.

In high-performance compute, we accelerated our momentum since closing the SGI deal late last year. Overall, the high-performance compute segment is an $11 billion market and is expected to grow around 6% to 8% annually over the next three years. And with the explosion of data across industries and sectors, the data analytics segment is growing at over twice that rate.

Over the past several weeks, I've been meeting with customers, and it's becoming increasingly clear that SGI and our existing high-performance computing business make a very powerful combination. Just this quarter we announced a number of new offerings for sectors, including life-sciences and financial services, as well as significant new supercomputer installations that are driving advances in space exploration, biology and artificial intelligence.

We will continue to lean into this space, as HPC becomes an increasingly essential component in today's data-driven world. And earlier this month, we introduced one of our most significant 3PAR flash storage innovations to-date, the next gen 3PAR operating system, which provides a foundation for hybrid IT as all-flash becomes the new norm.

In December, we announced HPE Synergy with HPE Helion CloudSystem 10, the industry's first private cloud running on composable infrastructure. This new solution gives organizations the ability to operate a single IT environment on-prem that supports both traditional applications and private clouds on shared infrastructure. It gives customers the security and control of an on-prem solution at public cloud economics. That is a game-changing combination.

Finally, we continued to deepen relationships with existing partners like Arista, and introduce new ones as well. For example, in Q1, we announced a new reseller agreement with Mesosphere.

HPE will build and deliver infrastructure solutions specifically designed for the Mesosphere data center operating system. For HPE, the agreement with Mesosphere shows how committed we are to helping enterprise customers fully embrace the benefits they want from hybrid IT, including optimized performance and faster service time to market.

Turning to the next pillar of our strategy, we believe the intelligent edge and the industrial internet of things represents a significant opportunity for our business going forward. We are very well-positioned with Aruba today and continue to make investments to strengthen our portfolio for the future.

In late November, Aruba announced several new security solutions, ecosystem partnerships and switching products designed to accelerate the move to the digital workspace, while addressing the security concerns associated with the adoption of IoT.

For example, the new Aruba ClearPass Universal Profiler gives IT organizations unparalleled multi-device management and security options across multi-vendored wired and wireless networks. And Aruba's latest switches and switch operating system are specifically designed to power and secure the intelligent edge, optimized for mobile and IoT devices.

And in Q1, we acquired Niara to help our customers detect and protect themselves against advanced cyber attacks that have penetrated their network perimeter defenses. Niara is a leader in a new category of products that employ machine learning and big data analytics on enterprise packet and log streams to discover advanced attacks. By integrating Niara's behavioral analytics technology with Aruba's ClearPass policy manager, we can now offer our customers the industry's most advanced threat detection and prevention solutions for networks and IoT devices.

Finally, today more than ever, our customers are looking for a trusted advisor to help them define and implement an IT roadmap specific to their business needs. Service is at the core of our ability to be that strategic partner to our clients, and its role in our business is crucial.

In Q1, we announced the acquisition of Cloud Cruiser, a leading provider of cloud consumption analytic software that provides clear insight into IT usage and spend and helps customers more effectively plan and manage their IT systems.

This acquisition will further differentiate our flexible capacity offering which, as you know, is a unique consumption model that enables our customers to manage IT infrastructure in their own data center but pay for it as a service. This approach reduces the risk of organizations investing too much or too little in IT, eliminates unused capacity and frees up valuable IT resources for new value-adding projects.

In the coming months, we will be speaking more to our customers about our services strategy. Leading that charge will be Ana Pinczuk, who joined HPE just last week from Veritas, where she most recently held the role of Executive Vice President and Chief Product Officer and from many years at Cisco prior to that. As a seasoned leader with 30 plus years of experience, Ana brings a wealth of services expertise, combined with a versatile background in engineering, sales and IT.

The best way to judge our strategy is through our customers. And our customer wins in Q1 gave us great confidence that we are on the right path. In January, the Tokyo Institute of Technology awarded HPE with a significant supercomputer win to address increasing demand for big data and artificial intelligence capabilities in research communities.

Suncor Energy has signed a five-year Flexible Capacity service agreement. Flexible Capacity provides Suncor with benefits of a cloud-like consumption model and the performance and security afforded by having these resources on-prem.

We are working with Giant Tiger, Canada's leading discount retailer who is implementing HPE Synergy to help consolidate and power their next-generation 600,000 square foot state-of-the-art distribution center.

Distribution and warehousing are core functions of the Giant Tiger business model and HPE Synergy will transform distribution operations with HPE Aruba wireless and 3PAR storage technology to run warehouse robotics. And next week at Mobile World Congress, we plan to announce a major smart cities project in India, involving the world's largest long range low-power wireless IoT platform deployment.

Overall, I would love to have seen better top line results in the quarter and we could have done without the market and execution headwinds I described earlier. But, I remain very confident in our strategy.

Nothing has changed my fundamental belief that HPE is on the right track. In fact, I believe we are ahead of many of our competitors in reorganizing to deal with the market challenges we all face. The steps we are taking to strengthen our portfolio, streamline our organization and build the right leadership team are setting us up to win long into the future.

With that, let me turn it over to Tim.

Tim Stonesifer
Thanks, Meg. As you said earlier, our overall performance in the quarter was somewhat mixed. We did drive solid growth in our higher margin businesses and continued to align our cost structure, which enabled us to deliver better operating profit versus the prior year. However, we also faced increasing pressures from currency, commodities pricing and soft markets, in addition to the execution issues Meg discussed. In total, revenue of $11.4 billion was down 4% when adjusted for currency and divestitures.

From a macro perspective, we continue to see an uneven global demand environment. Performance in the US was impacted by tough markets, particularly in servers and storage. Revenue in Europe continues to be weak, driven by the UK public sector. APJ was mixed, with good performance in Japan, more than offset by broad softness in the rest of Asia.

Currency movements were unfavorable throughout the quarter, which resulted in a year-over-year impact of revenue of 140 basis points. Gross margin of 28.9% was up 50 basis points year-over-year, but down 150 basis points sequentially. The year-over-year improvement was primarily due to continued progress in the offshore labor mix of Enterprise Services. The sequential margin drop was driven by normal Q1 seasonality in ES and software.

Non-GAAP operating profit of 9.2% was up 110 basis points year-over-year, but down a 190 basis points sequentially. Non-GAAP diluted net earnings per share of $0.45 was at the high end of our outlook of $0.42 to $0.46.

Non-GAAP diluted net EPS primarily excludes pretax amounts for separation charges of $276 million, restructuring charges of $177 million and amortization of intangible assets of $101 million. We delivered GAAP diluted net earnings per share of $0.16, above our previously provided outlook of $0.03 to $0.07, primarily due to lower than expected separation and restructuring charges.

Now, turning to results by business; in the Enterprise Group, revenue was down 6% as we continue to focus on profitability and align the organization for its future stay. Operating margins were down 70 basis points year-over-year and 60 basis points sequentially to 12.7%. However, operating margins were up year-over-year, adjusted for currency and the H3C divestiture.

We had several areas of encouraging growth across the portfolio including Aruba, up 20%; 3PAR all-flash arrays, up 29%; high-performance compute, up more than 30% including the acquisition of SGI and almost 10% organically, and 4% growth in our highest operating margin business, Technology Services.

Server revenue declined 11% due to a softer than expected core server market, combined with some execution challenges. And as Meg said, we saw lower demand from our largest tier 1 customer. We already have several actions in place to help shore up our core business.

First, we are making improvements in the channel with some process reengineering, and focusing more on SMBs through distributors and value-added resellers. Second, we are continuing to make investments in products like Synergy that will revitalize our competitiveness in blades. In addition to organic investments, we've also augmented our portfolio with the recent acquisitions of SGI and SimpliVity, which will strengthen our position in two high growth markets. Lastly, we continue to focus on cost takeout by flattening new organization, better aligning R&D to the market opportunities, and improving the go-to-market model.

Storage revenue declined 12% in a market that remains challenged, and we faced sales execution issues similar to our core server business. Results were also meaningfully impacted by NAND supply constraints that we are expecting to lessen as the year progresses. We also recently announced a simplified pricing model and bundled compression offerings with 3PAR that should help to improve win rates and stabilize revenue going forward.

Networking revenue grew 6%, driven by Aruba hardware that continues to take share and was especially strong in EMEA with several large new logo wins. We also saw growth in campus and branch switching, but data center networking revenue continues to be pressured. We are in the process of transitioning from our legacy portfolio to the new Arista partnership that is starting to ramp.

Technology Services continues to be a bright spot with revenue up 4%. Orders also grew year-over-year for the third consecutive quarter, giving us strong confidence that TS will grow throughout fiscal year ‘17. We saw encouraging performance in non-attach and proactive services, as well as Aruba services, which was up more than 10%. We also continue to improve service intensity, or attach dollars per unit, which helps to offset pressure from challenged hardware performance. We are very pleased to see TS grow, given its relatively high degree of profitability and recurring revenue stream.

Enterprise Services revenue declined 6%, with continued challenges in the UK public sector and normal account runoff. Operating profit improved 220 basis points year-over-year to 7%, as the team continues to execute on productivity improvements in delivery and sales. We continue to track against our longer term goal of 60% headcount in low cost locations and completed the quarter with 52% of our headcount in low cost centers, a year-over-year improvement of seven points.

Software revenue was down 1% as strength in security was offset by declines in IT management and big data. SaaS had another good quarter with 6% revenue growth, driven by solid performance in Fortify On-Demand and Digital Safe. The team continues to focus on disciplined cost controls, leading to a 400 basis point improvement in operating margins to 21.4%.

HPE Financial Services revenue grew 7%, its third consecutive quarter of year-over-year growth, driven by strong volume from last year and an increase in operating lease mix. Operating profit declined 340 basis points year-over-year to 9.5%, primarily due to a bad debt reserve release in the prior year. Financing volume declined 9% in constant currency on a tough compare from a one-time item associated with the split form HPI.

Return on equity was down 490 basis points year-over-year to 13.1%. Free cash flow, which is seasonally weakest in the first quarter, was negative $2.3 billion. However, when adjusted for the $1.9 billion of ES pension funding, roughly $300 million of restructuring and $300 million of separation payments, normalized free cash flow was approximately positive $200 million.

This improvement of approximately $500 million from the prior year is due primarily to less drag from working capital as we continue to see the benefit from structural changes we implemented in cash flow management. Within the quarter, we also benefitted from movements in other assets and liabilities, which is expected to reverse in the second quarter. The cash conversion cycle was 12 days, up 6 days sequentially, in line with normal seasonality.

Turning to capital allocation, during the quarter, we paid $109 million in dividend payments, which includes an 18% increase to $0.065 per share, and repurchased $641 million of outstanding shares, aligned to our commitments at our Securities Analyst Day.

Now, moving to our two spin-merge transactions. Both the ES-CSC and Software-Micro Focus transactions are on schedule and on budget. We filed an updated Form 10 and S4 for the ES-CSC transaction and anticipate filing final versions shortly with the expected close still on or around April 1st.

The Software-Micro Focus transaction is also progressing as planned and we continue to anticipate the transaction closing on September 1st. We’ve also made good progress removing stranded costs and continue to anticipate a $0.06 diluted EPS impact in fiscal year ‘17 with all costs eliminated on a run-rate basis by the end of the year.

Now turning to our outlook; when we look back to the original outlook provided at our Securities Analyst Meeting in October of 2016, there have been three significant developing headwinds; currency, commodity pricing, and some execution issues.

In regards to currency, the euro is currently hovering at $1.06 versus $1.10 when we originally guided fiscal year 2017 and we now expect FX to be roughly a two-point impact to revenue year-over-year. And as Meg discussed, while profitability was hedged through the first quarter, we will face a headwind for the remainder of the year. We are managing the challenge as much as possible through pricing actions but it often takes many quarters to recoup the full impact.

From a memory standpoint, prices increased roughly 50% last month, putting significant margin pressure on the Enterprise Group. We can mitigate some of this movement through pricing actions, but similar to currency, the extent of the mitigation is dependent on many factors, including competition and demand. So, it will take some time for us to work through the challenge.

Lastly, the EG execution issues will have some near term impact, which should alleviate throughout the year as we move quickly to resolution. Consequently, we feel it's prudent to reduce our fiscal year '17 non-GAAP EPS outlook by $0.12 in order to continue making the appropriate investments to secure the long term success of the business. I view these headwinds as more temporary in nature and expect to recapture much of their impact through pricing actions.

With that, we expect Q2, '17 non-GAAP diluted net earnings per share of $0.41 to $0.45, and we expect fiscal year '17 non-GAAP diluted net earnings per share to now be $1.88 to $1.98 from the prior outlook of $2.00 to $2.10.

From a GAAP perspective, we expect Q2 2017 GAAP diluted net earnings per share of negative $0.03 to $0.01 and we expect fiscal year 2017 GAAP diluted net earnings per share to now be $0.60 to $0.70 from the prior outlook of $0.72 to $0.82.

Keep in mind that this EPS outlook reflects the combined company as it stands today, with full year contributions from ES and software since we haven't yet closed the transactions. As is our typical practice, we will update our outlook when we close each transaction.

However, I do want to give you some information on how to think about the ES impact, since the close is quickly approaching. We expect the ES transaction to impact fiscal year 2017 EPS by approximately $0.42, including ES related stranded costs.

We also want to highlight that ES only earns roughly one-third of its operating profit in the first two months of the given quarter as most customer milestones are in the last month. Consequently, we expect the ES transaction will impact Q2 2017 EPS by approximately $0.08 including ES-related stranded costs.

Also, similar to the separation of HPE and HPI, the spinoff of ES will likely cause a one-time non-cash GAAP-only charge in the second quarter from certain changes to our legal structure. The details of these changes are still being finalized. So we have not incorporated the impact to our GAAP outlook, but we expect them to result in a material write-down of deferred tax assets.

Finally, turning to cash flow. While this reduction in earnings outlook does put some pressure on cash flow; we, are now expecting reduced ES pension funding payments, and we will maintain our full year fiscal year 2017 free cash flow outlook of negative $1.8 billion. As mentioned earlier, we do expect some of the timing benefits we saw in Q1 to reverse next quarter, so our Q2 free cash flow will likely be below seasonal norms.

Overall, while we are working through some near term challenges, like Meg, I am confident that we have an effective near-term action plan, as well as the right long term strategy in place to position the future HPE for success.

Now, 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 pickup 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 come from Sherri Scribner of Deutsche Bank. Please go ahead.

Sherri Scribner
Hi, thank you. If I look at the server and storage performance this quarter, the numbers were pretty disappointing and there seems to be a pretty significant deceleration. I think, the bears would say that the cloud model is taking more share and that's pressuring your core business. Can you maybe comment on your view about how much the cloud is impacting your server and storage business?

Meg Whitman
Sure. So listen, I think the cloud is impacting our server and storage business, but no more than we thought at the beginning of the year. And really, if you look at the server business per se, and our results, within tier one we had a much lower demand from a single large customer that I discussed on the call, and we were also more selective around focusing on profitable deals. And the good news is that helped server margins year-over-year, but it did depress the revenue a bit. I think we did deliver strong growth in a number of our higher margin, better attach areas, like, high-performance compute, mission critical systems and the addition of SGI.

And the good news is, we also have some things coming up that I think will mitigate that decline. We are ramping our Synergy offering. We have got the power of SGI and our high-performance compute that was part of HPE. We are also pursuing alliances very aggressively. When we owned ES, yes we did some business with Accenture and Capgemini and the Indian firms, but they were always quite wary of us, because they viewed us as owning a competitor. As ES gets spun off, there is a lot more opportunity for us to do business with those partners, and I think that will help mitigate the decline. So listen, I mean, I am optimistic that these actions will enable us to stabilize servers in FY17.

I will also say that Synergy is important, because Synergy allows us to provide on-prem private cloud alternatives at public cloud economics, both the total cost of ownership, as well as, the consumption based pricing model. And we have seen a number now of customers move workloads off the public cloud back into an on-prem datacenter because it's more cost effective. So that's the server part.

Storage was challenged, I think by a continued contraction in the traditional portfolio. Remember, we still have tape and some very old storage products that are in decline. And we also were impacted by SSD supply constraints. But on the positive side, all-flash grew almost 30% and would have been considerably higher than that without the SSD supply constraints. And then we also announced a simplified pricing model and bundled compression offerings with 3PAR that was previously actually a competitive hole in our product.

But one last thing is, of course, with the SimpliVity acquisition, we've got now a whole new group of storage sellers where we can have broader market coverage, and we've become more scaled in that area. So listen, there are real pressures, no question about it, but I don't think particularly more than we thought there was going to be in the quarter.

Sherri Scribner
And then just as my follow-up, you took the full-year guidance down by about $0.12, but if you look at the first half, it doesn't seem like there was that much impact to the first half whereas most of the impact will be in the second half. Can you talk about the linearity of the FX impact and the commodity impact that you guys mentioned as being part of the takedown in guidance? Thank you.

Tim Stonesifer
Sure. So, if you look at FX, as an example, we have a rolling hedge program. We do that by country, we do that by product. So what you are seeing is the hedges that we put in place, call it six to nine months ago, which were favorable as they were all rolled up in Q1, so there was no real impact from an EPS perspective driven by foreign exchange. And then when you look at DRAM pricing as an example that increased about 50% in the month of January. So, again, we had some supplies built up or some inventory built up, so you don't see the full effect of that. So, you will see both the FX and the commodity pricing flow through the rest of the year. Now, we are going to try to price for some of that. We've gone out with price increases and it's really a question of what would the impact be to demand, and what will be the competitive response. So, you will sort of see a flow through, I would say, in sort of typical seasonality.

Sherri Scribner
Thank you, Tim.

Meg Whitman
Sherri, let me add one thing about the EPS takedown of about $0.12. So, when you think about commodities, and you think about foreign exchange that was about…we estimate about $0.12 of degradation. And the decision we had to make is, did we want to cut $0.12 more of cost out of our cost structure. And as you all know, we have been taking a lot of cost out of this company over the last four and a half years. And my view was, we have got very good investments in field selling costs, in innovation, in automation, in IT, that is going to put us in very good stead for the long term, and I did not think it was the right thing to do to absorb all of that commodities and foreign exchange degradation by cutting more costs into, what I think are going to be very high return capital return on investment projects. So, we decided actually that the best long-term thing for the company was to not cut into bone and meat.

Andy Simanek
Great. Thank you, Sherri. Can we have the next question, please?

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

Toni Sacconaghi
Yes, at your analyst day and also on your earnings call at the end of the year, you provided three sets of the guidance, one for HPE as is, which quite frankly is completely irrelevant at this point, given that you are going to be spinning off Services. And you also provided guidance of $1.45 to $1.55 for the current year and $1.25 to $1.35 in EPS for RemainCo. Can you provide updated guidance for RemainCo go forward and current year? And I guess the question is, given that the erosion appears to be all in the Enterprise Group, in fact, software and services were better than my numbers; should we be thinking about lowering the current year $1.45 to $1.55 by $0.12 and thinking of RemainCo earnings thereafter as being notably lower than the $1.25 to $1.35, and why not?

Tim Stonesifer
Yes, so let me take a cut at that. So, we did guide the $2.00 to $2.10 as a combined company, because again similar to prior practices, until we actually separate we will provide that outlook, and then we will adjust that outlook once the transactions have closed. So, to one of your questions around the as reported guide. The takedown would apply to that, so, the $1.45 to $1.55 would go down by $0.12 on both ends of the range. And again, that's primarily driven by the FX, commodity pricing and some execution challenges. When you look at the $1.25 to $1.35 number, you know, from an ongoing perspective because obviously we are not going to report that guide on a quarterly basis, it does have the 2017 assumptions in there. I think, you will still get within that range longer term, it really depends on how those price increases that we have executed, how those take. So, the more that they take, you would be up at the higher end of that range, if they don't take, given demand or competitive response, you would be at the lower end of that range.

Toni Sacconaghi
Okay, and then just to follow-up, if I go back to when you last reported earnings in late November, the currency bundle really hasn't changed much, and I appreciate that DRAM pricing has changed in the month of January. But, I think most people were aware of a much tougher commodity environment in November, in fact, your sister company HPQ had been calling that out well before November, and it made provisions to adjust for that both in pricing and in building inventory. So, I guess the question is, the only thing that really seems new or that you shouldn't have known about was either the market changing or execution. Did you…were you aware of these, I am sure you were aware in November did you just think you could overcome them, and that's why you didn't update your guidance at the end of November or should we really be thinking that the market and your execution are really what the material differentiators are in terms of your choosing to lower the guidance now as opposed to in November when at least two of the forces were very apparent?

Tim Stonesifer
Yes, so, I will address that one, and Meg you can jump in here if you would like. So, let's start with FX. I think, to your point, we guided in October for the full year 2017 outlook at SAM. So, at that point in time, the euro was trading at call at 1.10 and the yen, which has another significant impact was trading at about 103, when we came out on the fourth quarter earnings call, we did highlight that there was some pressure. So we got a question, I can't remember who asked it. And we said, yes, rates are less favorable than they were. I think at that point in time the euro was about 1.06, and the yen as was at about 110, 111, but given the fact that we were three weeks into the year, given the fact that, we were rolling into a new administration in the US, and we weren't quite sure how that was going to play out, as well as the fact that we had hedges in place that protected the first quarter, we decided to continue to monitor the currency environment. We would make some operational changes that we thought were appropriate. And then that's why we didn't change the guide then.

As we sit here today, we are now five months into the year, and that euro was still sitting at about 1.06, the yen is still sitting at about 112. So, we felt it was prudent to adjust our guide now. And it's really driven - it was a cognitive choice that Meg alluded to is we had choices that we evaluated and we decided this was a prudent thing to do, so we could continue to drive the strategy, we could continue to make the strategic investments that will drive long-term value. So that's the foreign exchange piece.

And then, on the DRAM piece, those prices spiked about 50% in January. We did do some advanced purchases in the fourth quarter, but there was only so much you could buy because everybody sort of was facing the same thing and there is only a limited amount of capacity. So, again, that's why you didn't see a lot of that pressure in our Q1 EPS, because we were using inventory that we bought at lower pricing. And that's something that will continue to play out in Q2, Q3 and Q4, I mean, it depends on how the capacity comes on line. And we really don't see foreign exchange changing drastically as we go forward as well. So, hopefully, that answers your question.

Toni Sacconaghi
Thank you.

Andy Simanek
Great, thank you, Toni. Can we have the next question, please?

Operator
The next question will be from Kulbinder Garcha of Credit Suisse. Please go ahead.

Kulbinder Garcha
Hi, thank you. Just a couple of clarifications really, maybe for Meg; I think you've talked about your TAM growing to 2% to 3%, and at constant currency backing out acquisitions et cetera. I think you have hit a growth rate in that range or above that range about half the time in separation and half the time that hasn't been possible, since you've separated. And that's a reasonable amount of time now. I am just wondering, do you still believe in that growth rate being an industry participant? Do you think HPE can consistently hit those numbers, and if not, does something maybe you have to change on the M&A front to accelerate that growth in the revenue side? That's kind of my first question. And then, the second one on restructuring and cost savings, the fact that you are choosing not to take more cost out given the current challenges that you are seeing, does that also tell us that the efficiency drive and the

inefficiency that HPE may have had in its cost, now, and now it's going to be much more difficult balancing act between projects you want to keep and eliminating just redundant cost? Thanks.

Meg Whitman
Yes. Okay, so, let me address the growth question. I think you are probably right that we have grown about half the quarters since we separated. And you've got to look at first, what is going to be the go-forward Hewlett Packard Enterprise, as opposed to also the whole company because in much of the last year, obviously Enterprise Services was more of a drag than EG was. But, let me answer the question about go-forward Hewlett Packard Enterprise which in 2017, which is EG plus HPE Financial Services. I would say, yes, I think we can return to growth, but there is one caveat that I would make, and that is a single tier one service provider who was a big customer of ours, who is slowing down orders dramatically. But, for the rest of the business, ex that large single tier one service provider, I think we have set ourselves up well to be prepared to tackle the future. I like our portfolio; we have really reshaped this portfolio both inorganically as well as organically. I think you should feel very good about TS.

Remember, over the last three or four years there was a lot of question, could we return TS to growth? And orders pre-cursors revenue, we have seen orders grow, and the last couple of quarters you have seen revenue grow and orders grew again this quarter. So, we are very confident about the TS growth rate and of course that happens to carry a much higher margin than our infrastructure products.

Aruba continues to do very well, and as I said, some of our other high growth areas. So, I am going to say, yes, with the possible exception of the single tier one service provider and that could throw us into slightly negative growth for 2017.

On the cost out, listen, we have taken a lot of cost out of this company. We have improved the efficiencies, the business process reengineering. And by the way, embedded in our forecast for 2017 is all the reshaping that we did around RemainCo, costs are coming out. We have totally reshaped how that business is run with far fewer layers and much more efficiency. So, that will continue, I do think after we are separated there is going to be potentially some more cost to come out. Right now, we are carrying almost the full IT load because the IT team is doing all the separations. We will skinny down IT, obviously, some of IT will go to software, some, will obviously go to CSC. So, I think that will help us. And then there are some other things that we can go after, but I have to say, quite honestly, the low-hanging fruit is gone.

Tim Stonesifer
Yes, just to elaborate on that a little bit. If you look at our OPEX for Q1, we were down year-over-year about $340 million. Now, granted we had the TippingPoint divestiture. So, I will call it from an operational basis, it's roughly $220 million. So, we do have a lot of cost takeout in the plan, we are executing upon that. I think, when we get to and we talk a little bit about this at some point, when you get to the Q4 of 2017 we do this benchmarking as an example on all of our functions. From a run rate perspective, we will be at that benchmark, except for the IT and the real estate component. So, again, it takes us a little bit of time to get through the separations, and then we can really zero in on the IT and the real estate front to continue to capitalize on those savings. But, I think our view is, there is always opportunity for cost, it's just a question of how much and how quickly can you take that out. And right now, we feel like we are taking out quite a bit of cost.

Andy Simanek
Great, thank you, Kulbinder.

Kulbinder Garcha
Thank you.

Andy Simanek
Can we have the next question, please?

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

Steve Milunovich
Thank you. Hey, Meg, could you talk a bit more about these management changes, you mentioned the head of Sales, the head of TS, who I thought was supposedly doing a great job. You have always spoken very highly of him, and all these geos. I mean, it seems to kind of coincide with the spins-offs, but, I don't know why that would affect a lot movement around EG. So maybe you could talk about some of the individuals involved and why all the changes?

Meg Whitman
Sure. So, remember, as we go forward as Remain Co, if you will, which is EG plus HPE FS. We need to set up EG to be a very lean and cost effective competitor because, guess what, in Europe we compete against the Chinese, obviously it is a very, very competitive market. So we wanted to reorganize ourselves in a way that we thought would be much more cost effective and more efficient. And the first was, we appointed Peter Ryan to be the new head of global sales. We have actually never had a head of global sales, he is now the head of global sales, and he has got three new regions heads, Jim Merritt, who used to be in Asia and did a fantastic job for us in Asia has come back to the United States. And then we promoted Andy Isherwood to be the head of Europe, who filled in behind Peter Ryan, because he had been head of Europe, so I have got three new region heads plus Peter being a new head of Global Sales. They are not new to HP, but they are new in their roles.

Secondarily, we have now real plans to grow TSS, which is our Technology Services Support business, as well as TS Consulting. So, Scott Weller still runs TSS, Rafael Brugnini still runs TSC, but, we have hired someone to take both of those businesses and really drive growth overall in the services business, because we have got to grow our advisory and transform service. We have to grow our support services business as we have in the past. And there is a lot of opportunity in some of the new products, particularly around flexible capacity services.

So, we hired a new executive named Ana Pinczuk, who is going to be in charge of all services, Scott Weller is still in place, and we think very highly of Scott, and Rafael Brugnini is still in place. We also hired a new leader for our channel program. We had a fellow who was hired in a number of years ago, who actually did a very good job for us, but was really focused on selling cloud services. And so, we actually hired a fellow by the name of Denzil Samuels, who has a long history with the channel. He most recently was at GE. And so he has come in, in the last month or two months to run all channel worldwide. Yes, Scott Dunsire is still in place in the United States. And so, we have got consistency there, but we do have a new head of the channel.

So, I think all these folks to some degree were also doing double duty. We were making divestitures. We were doing M&A. We were doing separations. And Antonio was doing a lot of double duty as well. So, I think, the good news is, largely that is through the pipeline or through the pylon, if you will. And I am feeling pretty good about people settling into to their new roles. But quite frankly, I probably put more change into this organization in Q1, then I probably should have.

Tim Stonesifer
And I wouldn't, I mean, this doesn't go under the org change category, but, I wouldn't underestimate at the local level, the impact on the country leaders which obviously do a lot of selling for us. I mean when you do a separation like this, you have to go out and speak with customers, you have to explain to them the ES separation from HPE. You have to deal with workers' councils if they are going to be any organizational changes. So there is quite a bit of work that kind of ripples through the organization.

Meg Whitman
And we have got two separations going on now at once. And I will add one more thing. When we separated HPI from Hewlett Packard Enterprise, it was one family there, was one adult that was supervising both the separation of the siblings. Now, we are doing separations that is a merger with the third party, and that actually adds the complexity that we knew about, but has created some complexity. And by the way, the most intense time for the ES separation was in Q1, no question about it. And now, we are on sort of the nice glide path to March 31st.

Steve Milunovich
Okay, fair enough. You talked about market's being difficult, but can you talk a bit about competition, particularly against folks like Cisco, Lenovo. And do you feel like you are missing a window a bit to take advantage of whatever disruption is happening at Dell EMC?

Meg Whitman
No, I think we actually did quite a good job of intercepting that merger, and we've recruited a lot of new channel partners, they're beginning to ramp, much as we did a good job intercepting the server move from IBM to Lenovo, that we did a very good job intercepting a lot of that business. So, I think we've taken advantage of that to some degree. Lenovo is around…they've got their hands full on a couple of other things, the server business and Motorola. But, Dell is being very aggressive, particularly in the server side of things. And we're countering that. When we think it makes the right sense, we're not doing share for share sake here but we're being smart about it.

And then in Europe, we actually are seeing the Chinese. We're seeing Huawei being more aggressive. And we're trying to avoid what we learned in the PC business, which is they do the land and expand. If you can keep them from landing, then that is a much better long-term strategy. So, we're working hard on that too. I would also say that joint venture in China is actually working quite well. There's been some growing pains there but actually we're quite optimistic about that and optimistic about the Tsinghua team that is now in charge of that business. And listen, given the trade situation and what may or may not happen with the administration, I'm very glad I'm part of a joint venture in China.

Andy Simanek
Perfect. Thank you, Steve. Can we have the next question, please?

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

Katy Huberty
Thanks. Good afternoon. When I look at the storage business, a number of the headwinds you're discussing, including the clients in the legacy business and higher commodity prices or dynamics that some of your big competitors also face. And yet, when I look at NetApp, the closest public peer, they grew their business 5% sequentially; your storage business declined 12% sequentially. So, that's a huge gap. And I just wonder, if you can talk a little bit more about what changed your momentum so quickly relative to peers, and then what needs to be done to get back on track?

Meg Whitman
Yes. So, I would say, listen, the bright spot in the storage portfolio continues to be the all-flash growth, which was almost 30% and it would have been considerably higher if we'd had more SSD supply. So, we're feeling really good about our all-flash display...I mean, our all-flash product. Some of the other parts of the business were weaker than probably they should have been. I think I will attribute some of that to execution and some of that to market. So, we're not happy with the storage performance this quarter. I'm quite happy with the all-flash situation but there's other things that we're going to buck up as we go forward. So, I think that's the way I would characterize the quarter.

Katy Huberty
And then, the weakness at a major tier 1 service provider, can you talk about that little bit more, is that a HP year-on-year comp issue, or is there just a change in the momentum of buying at that particular customer?

Meg Whitman
It's actually both, it's a year-over-year comp issue and it is a different buying pattern than had been anticipated. And so, we will see if that corrects over the next two or three, four quarters. Built into our forecast is that it does not correct. So, if it does, that would be an upside. And again, remember, these tier 1 deals, we do make money on them but they are not as profitable as the core ISS. So, that doesn't translate as dynamically into operating profit as it does to revenue. So, they are facing a very competitive business; the tier 1 business is very competitive, and we'll see what happens there.

Katy Huberty
Thank you.

Andy Simanek
Thank you. Can we have the next question, please?

Operator
The next question will be from Maynard Um of Wells Fargo. Please go ahead.

Maynard Um
Hi, thanks. Within TS, if I exclude the SGI services business, which I presume is in there, I'm calculating that the core TS was maybe down around on 2% year-over-year. And I'm just wondering if this is purely a function of slowing hardware or is there slowing in that re-classed ES revenue that you moved in there? And I guess, what I'm really trying to figure out is whether the larger hardware declines that are happening now, will have an adverse impact on TS or if the new services are now growing significantly more? And then, I have a follow-up.

Meg Whitman
So, Maynard the organic TS result was 2.5% in constant currency, so 2.5% growth in constant currency. So, we're actually feeling pretty good about that. And it is driven by the new product acceleration, data center care, proactive care, FSC. And if you go back three or four years on TS, in all rights for a while there that business should have been down 25% a year because it was so driven by our mission critical business.

The TS team deserves a huge amount of credit for diversifying the product and actually having that business down only single-digits. Now, with the new products coming on line and being actually quite successful, orders are up and we anticipate that business will grow organically, forget adding the SGI services on top of that. So, we're feeling pretty good about that business and anticipate we're going to see growth.

Tim Stonesifer
Keep in mind, in that business, about 85% of those revenue streams are recurring. So, that's why we are confident in the growth throughout the course of the year.

Meg Whitman
Yes. And so, listen, a lot of the server business that was weak, didn't have high attach to it anyway. Okay, so, tier 1 service provider has no service attached to it. So, it's not a drag on our services business.

Maynard Um
Great. And then, with the incremental cash you'll be getting from the divestitures, any guidance on how you intend to use that cash, particularly against the backdrop of the Company being more acquisitive lately, and the possibility for a tax repatriation holiday? Thanks.

Tim Stonesifer
Yes. So, I think that we are going to continue to execute the returns based capital allocation strategy. We feel like that that's been working well for us. So, in Q1, as an example, we will return $750 million in cash in the form of share repurchases and dividends. So, we're still committed to that $3 billion that we've talked about at SAM, again in the form of share repurchases and dividends. Now, I will say, we are biased toward share repurchases. But, we feel like that framework is working well with us, and we are going to continue to operate within that framework.

As far as the repatriation, we haven't incorporated any of that into our plans because we are not sure what is going to happen, to be quite honest with you. But, if there was a onetime holiday as the majority of our cash is offshore, we would certainly benefit from that, like many other companies. But, I would just balance it with, even if we were to see some sort of holiday, I'm not so sure that it would change our returns based approach, I'm not so sure it would change our approach or strategy towards M&A as we go forward.

Meg Whitman
I agree with that. I mean, remember what we've said is the kind of acquisitions that have worked well for this Company are 3Com, 3PAR, Aruba; SGI is actually going to be very successful and SimpliVity, we're excited about it; it's too new to declare a victory, we just closed on Friday. But what do they have in common? They've got reasonable valuations; they leverage our distribution channels, they're complementary technologies and they drive profitable growth. So, I think, the best indication of the future is the past.

Andy Simanek
Thanks, Maynard. I think we have time for one more question, please.

Operator
And that will be Shannon Cross from Cross Research. Please go ahead.

Shannon Cross
Thanks for fitting me in under the wire. Just can we go back to the tier 1 service provider? I'm just curious as to whether or not the changes you saw there were basically a slowdown from a capacity need for them or was it a competitive decision, so you're just facing more competition, maybe from white box? I guess, I'm trying to figure out if this is sort of just a one-timer or if there is something fundamentally changing in the business model?

Meg Whitman
Yes. I mean, I'm not entirely sure; what I will tell you is that they have dramatically decreased their purchasing below commitments that they had made to us.

Shannon Cross
Okay. And then, Tim, just a quick clarification, and maybe talk a little bit about cash flow during the year. You gave a few comments on how we should think about it from a linearity standpoint for fiscal second quarter. But, I just wanted to confirm it, so we're down to $1.9 billion, then what should be the pension funding? And then, is there anything - so, that's all done now; there won't be any more coming out, I guess in this quarter? And then just how should we think about the opportunity to drive more working capital out of the model? Maybe, you're not going to be cutting costs as much in the P&L but is there more room from a working capital standpoint, as we look forward?

Tim Stonesifer
Yes, sure. I'll just give you a total year perspective. So, our guide, we're still comfortable with the negative $1.8 billion. We have, to your point, we've paid out the $1.9 billion in pension. Now, there are some more payments to be made because we don't finalize everything until we close the transaction. But, we do expect that those payments will be less than the $2.5 billion that we had communicated at SAM. So, we'll see some favorability there. The reason why we're sticking with our guide is because obviously with the $0.12 takedown, that drives some earnings pressure. So, net-net, we still feel very comfortable with the free cash flow guide. As far as working capital, again, we have some timing elements here and there. But, I would say overall assumptions over the course of the year have not changed since the guidance we gave at SAM.

Shannon Cross
Thank you.

Andy Simanek
Great. Thank you, Shannon. So, I think with that, thank you everyone for joining today. And we'll wrap up the call. Thank you.

CONCLUSION

Operator
Ladies and gentlemen, the conference has concluded. Thank you for attending. You may now disconnect your lines.