Hewlett Packard Enterprise Company

Q1 2020 Earnings Conference Call

Tuesday, March 3, 2020, 5:00 PM Eastern

CORPORATE PARTICIPANTS

Antonio Neri - *President, Chief Executive Officer*

Tarek Robbiati - *Executive Vice President, Chief Financial Officer*

Andrew Simanek - *Head of Investor Relations*

PRESENTATION

Operator
Good morning, afternoon, and evening and welcome to the First Quarter 2020 Hewlett Packard Enterprise Earnings Conference Call. My name is Shawn and I'll be your conference moderator for today's call. At this time, all participants will be in a 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 like to welcome you to our fiscal 2020 first quarter earnings conference call with Antonio Neri, HPE's President and Chief Executive Officer; and Tarek Robbiati, 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 earning release on our HPE Investor Relations' web page 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 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 amount ultimately reported in HPE's quarterly report on Form 10-Q for the fiscal quarter ended January 31st, 2020. Also, 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. Throughout this conference call all revenue growth rates, unless noted otherwise, are presented on a year-over-year basis, and adjusted to exclude the impact of currency.

Finally, please note that after Antonio provides his high-level remarks, Tarek will be referencing the slides and our earnings presentation throughout his prepared remarks. As mentioned, the earnings presentation can be found posted to our website and is also embedded within the webcast player for this earnings call.

With that, let me turn it over to Antonio.

Antonio Neri
Thanks, Andy. Good afternoon everyone. Thank you for joining us today. HPE's first quarter results demonstrate continued progress against our strategic priorities to shift our company to higher margin and more recurring revenues against a dynamic market backdrop. I am disappointed that our overall revenue, $6.9 billion, reflects a 7% decline for the quarter, primarily due to declines in our Compute business.

However, I am pleased with the results in several key areas of our business aligned to our strategy. Our pivot to as-a-service is gaining momentum. Our Annualized Revenue Run rate grew 19% year-over-year. We started reporting this new metric last quarter to provide more transparency into the recurring and higher margin benefits of shifting to our as-a-service model.

We grew HPE GreenLake services' orders 48% year-over-year. HPE GreenLake gained 65 new logos in Q1 and has surpassed 800 total customers. We returned to growth in our Intelligent Edge business with revenue up 4% year-over-year. And we continue to see profitable growth in areas of investment including High Performance Compute, Hyperconverged Infrastructure, Big Data Storage, and Operational Services orders with continued improvements in our services attach intensity.

Our Q1 revenues were impacted by a number of factors. First, like many of our peers, we continue to see uneven and unpredictable demand due to macro uncertainty. This has resulted in longer sales cycles and delayed customer decisions.

Second, commodity supply constraints disrupted our ability to meet our customer's demand this quarter, particularly in our Compute and High Performance Compute businesses. Additionally, the outbreak of the coronavirus at the end of January impacted component manufacturing, resulting in higher quarter end backlogs. In both of these cases, we have established specific mitigation and recovery plans with each of our suppliers.

Finally, we encountered a challenge in consolidating a manufacturing site in North America. We have a plan in place to address the Q1 issue and are confident that our efforts will result in increased efficiency and agility as we move forward.

It is important to note that, even with the revenue shortfall, we improved our non-GAAP gross margin by 210 basis points year-over-year to 33.2%. We drove non-GAAP earnings per share of $0.44, up 5% year-over-year, and in line with our outlook, while also investing for future innovation. And we delivered improved free cash flow compared to last year's level and in line with Q1 normal seasonality.

While market uncertainty continues and new global developments like the coronavirus have emerged, we have taken the right actions to mitigate against these evolving dynamics. Some of these actions include further cost account in our backend operations as a part of our HPE Next program, which has been a key enabler of our gross and operating margin improvement. We had extended the program through fiscal year 2021 and expect incremental savings while maintaining the original net cash impact.

As Tarek will cover in more detail, because of the actions we have taken to address the uncertainty and the expected recovery of supply chain constraints over time. We are comfortable maintaining our fiscal year 2020 non-GAAP EPS outlook. But there are too many unknowns at this point to provide second quarter guidance.

Also, we do feel it is prudent to revise our fiscal year 2020 cash flow outlook from $1.9 billion to $2.1 billion to $1.6 billion to $1.8 billion. Given that we expect some impact on cash conversion cycles driven by the ongoing recovery from supply constraints and the impact of the coronavirus. These are the right pragmatic actions to take and I am confident in our ability to deliver in our strategy.

Our customers continue to reaffirm their need for hybrid capabilities to advance their digital transformations and harness the power of their data, wherever it lives--in the cloud, on and off premises and increasingly at the edge. As the edge-to-cloud platform-as-a-service company, HPE is uniquely positioned to capitalize on these trends and help our customers transform.

Before Tarek provides more specifics about the quarter, let me highlight a few of our business and segment results. First, our Intelligent Edge business outperformed competitors across the industry. We grew in all geographies, posting double-digit growth in North America, despite the challenging macro environment, and we delivered double-digit growth in our Aruba-branded products. Over the last two quarters, we have been actively enhancing our sales coverage model in North America, and I am proud of the team’s hard work and our momentum.

We declared the opportunity at the Intelligent Edge early and we continue to invest in bringing a a cloud experience to the edge, where data is increasingly created. At the core of the strategy is HPE Aruba Central, the only cloud native and simple to use platform that unifies network management, AI power insights, and IoT device security for wired, wireless, and WAN networks and soon 5G and edge computing. More than 58,000 unique customers are using Aruba Central.

In Q1, Aruba, which pioneered the software-defined branch solution for the deployment and management of large retail networks - further enhanced our solution by integrating Aruba Branch Gateways with Aruba Central. By providing a single point of control for SD-WAN, wired and wireless networking, Aruba can help customers achieve secure, simplified branch connectivity at scale.

Our customers continue to recognize our innovation at the edge. For instance, in the first quarter, the Office of Information Technology at Princeton University turned to Aruba AOS-CX to support its wired initiative and seamlessly integrate with Aruba Wireless with a goal of creating a complete mobile first campus of the future.

Sub-Zero, a leading luxury appliance maker, updated it's wired with wireless infrastructure through Aruba AOS-CX and Instant Wireless to support IoT in high-end appliances.

Both our Aruba AOS-CX and Wi-Fi 6 solutions continue to gain traction in the market. The customer examples I share are a testament of our differentiated innovation. I am excited about how our market leadership is helping customers to redefine experiences at the edge. We will continue to enhance our portfolio with integration of 5G and mobile edge computing to capitalize on this significant opportunity.

Turning to Hybrid IT, as we announced at our Securities Analyst Meeting last fall, we are providing revenue and operating profit disclosures in four business segments: Compute, High Performance Compute & Mission Critical Systems, Storage, and Advisory and Professional Services aligned to customer demands and market trends.

Tarek will walk you through the financial results in greater detail, but let me share a few high-level observations. As I noted earlier, our Compute revenue was impacted by a combination of factors

and came in lower than anticipated for the quarter. However, we did see an acceleration in unit volumes, which were up mid-single digit year-over-year, excluding tier 1 and China.

Our High-Performance Compute and Mission Critical Systems segment includes the first full quarter of Cray. We are excited about the combination of HPE and Cray and the growing TAM. We have been awarded more than $2 billion in HPC business, expected to be delivered in the next three years. Programs include the U.S. Department of Energy's "El Capitan" system at the Lawrence Livermore National Laboratory and "Frontier" supercomputer at Oak Ridge National Laboratory, among others.

Our new segmentation provides greater insights into the size, strength, and attractive financial profile of our HPE Storage business, which is a $5 billion business with an operating margin of 18%. We gained momentum in key areas during the quarter and expect to gain share in external disk.

Big Data storage grew 45% year-over-year and demonstrates early success with our MapR acquisition. Hyperconverged Infrastructure also continued to grow, up 6%. HPE InfoSight, our cloud-based AI operations platform, gained momentum across both Storage and Compute. I am proud of our focused efforts and innovation that have created one of the most comprehensive intelligent data platforms in the industry, which will continue to provide customers with superior simplicity and performance.

Our Advisory and Professional Services business provides strategy, technology planning and consultant services that help customers navigate their digital transformation from edge to cloud. With the increased focus and simplification of this business, we drove demand across the HPE portfolio and significantly expanded operating margins this quarter, up 12.5 points year-over-year.

Our customer wins demonstrate the strength of our strategy and breadth of our portfolio. For example, HPE was recently selected by Zenuity, a joint venture between Volvo Cars and Veoneer to help make next generation autonomous driving cars reality. HPE will provide the crucial AI and high performance computing required to gather, store, organize, and analyze data from its global network test vehicles and software development centers. The end-to-end solution will be delivered as-a-service through HPE GreenLake.

Rohde & Schwarz, a global electronics company, wanted to reduce storage complexity and reclaim management time. Already relying on 3PAR for business critical applications, the company choose Nimble Storage to help manage a 20% year-over-year growth in data. This new combination has improved performance threefold.

Volkswagen Group selected HPE to deliver state-of-the-art Compute and Mission Critical servers to run its apps and solutions, like SAP HANA, Virtual Desktop Infrastructure and others focused on big data analytics, AI and autonomous driving. Our offerings such as HPE Superdome Flex, HPE ProLiant Gen10 servers, and HPE Pointnext Support Services will power the data and apps for the Volkswagen Group's 12 global brands.

In Q1, we continued to accelerate innovation. We achieved a major milestone in our pivot to as-a-service with the launch of HPE GreenLake Central platform. HPE GreenLake Central is an advanced cloud platform that provides customers with a consistent cloud experience for all their applications and data, wherever they live - through an operational console that runs, manages and optimizes their entire hybrid estate.

We launched our HPE Container Platform, which is the first enterprise-grade Kubernetes-based container solution. It leverages HPE's acquisition of BlueData and MapR together with 100% open source Kubernetes software. This platform provides customers with a common and faster path to run legacy and cloud native applications with persistent storage connectivity.

And we acquired Scytale, an innovative software company focused on service authentication. The Scytale team are the founding contributors to two open-source projects that are positioned to become the defacto standard for identifying and securing enterprise workloads both on- and off-premises. Our Scytale acquisition is consistent with our targeted approach to M&A that brings critical talent and complementary technologies to HPE. We look for accretive, value-enhancing acquisitions that improve our competitive positioning and accelerate our strategy.

Finally, our HPE Financial Services business continues to provide us with the critical competitive advantage. In Q1, overall financing volume increased 2%. GreenLake represented more than 40% of our HPE leasing volume.

HPEFS uses multiple levers to help customers accelerate their digital transformations while contributing to the circular economy. Through asset up-cycling and accelerated migration, HPEFS freed up well over $500 million in our customers' budgets over the last two years. This business helps our customers capture value from older assets, achieve their sustainability goals, and invest in new technologies as-a-service.

As we advance our business objectives to meet our customer needs and deliver for our shareholders, we continue to be guided by a very strong purpose. I am tremendously proud of our environmental stewardship, our investments in our people, and our culture of integrity and inclusion. HPE was just recognized as one of the most ethical companies by Ethisphere Institute. We were also proud to be named to Bloomberg's Gender Equality Index. These are very important measures of how HPE delivers for our team members, customers, shareholders and our global communities.

In summary, in Q1 we faced continued macro uncertainty, which combined with supply and manufacturing constraints, impacted our revenue, particularly in Compute. Despite, these issues and the current market backdrop, we continued to execute with discipline and make progress against our strategic priorities.

We outperformed the market in critical areas, like the Intelligent Edge. We gained traction in High Performance Compute with the acquisition of Cray. We advanced our pivot to as-a-service, all while delivering EPS and gross margin expansion.

While we made progress in these important areas, we know we have work to do to improve in others. We are living in an uncertain time, but what is certain is our commitment to continue to manage our business with focus and discipline.

I believe in our sound strategy, in our talented team, and in our differentiated technology. This combination will enable us to execute our pivot to provide our customers and partners unique edge-to-cloud experiences, delivered as-a-service. By doing so, we expect to deliver long term profitable growth and generate stakeholder value.

With that, let me turn it over to Tarek to provide more details about the quarter.

Tarek Robbiati

Thank you very much, Antonio. Now, let me provide more detail on our financial results for the first quarter of fiscal year 2020. As I have done before, I'll be referencing the slides from our earnings presentation to highlight our performance in the quarter.

Also, please note that we are now reporting results according to our new segmentation. This will provide more granular detail on the financial performance of our businesses and our progress towards becoming the edge-to-cloud platform-as-a-service company. Please refer to our recently filed Form 8-K for more detailed information, which includes historical reconciliation tables for the last two years.

Antonio already discussed the high-level points for the quarter, but I want to briefly reiterate the main takeaway. We are continuing to execute on our transition to higher margin and more recurring revenue areas in a challenging business environment. We also remain confident that we have the right strategy in place and are taking the right actions to lay a foundation for sustainable, profitable growth in the future.

Turning to slide two, with the financial highlights for the quarter. Despite the top line challenges from uneven demand and component supply and manufacturing constraints that I'll provide more detail on shortly, we continued to expand non-GAAP gross margins, which improved by 210 basis points this year, driven primarily by portfolio mix shift, cost of services, efficiencies and commodity cost tailwinds.

This gross margin expansion, combined with other income and expense benefits that included record equity interest contributed from our ownership in HPC and share buybacks, resulted in diluted non-GAAP EPS of $0.44, which is up 5% year-over-year and in line with our original outlook for the quarter.

On the cash front, free cash flow was a use of $185 million, which was in line with the prior year and normal seasonality. Consistent with our capital management policy, we paid $156 million in dividends and repurchased $204 million in shares.

From a macro perspective, as Antonio mentioned, geopolitical factors continue to cause business uncertainty, particularly in larger enterprise deals, creating an uneven and unpredictable business environment.

This was further exacerbated by supply constraints, both component shortages and our North American manufacturing site consolidation, which affected the Compute business in particular. We expect component shortages to remain a headwind and this situation to alleviate as we progress through the year.

The North American manufacturing site consolidation has created near-term execution challenges that we are actively addressing and expect to have improved efficiencies and agilities in our supply chain moving forward.

Adding to the uncertainty is the potential disruption to demand and supply caused by the coronavirus outbreak. The health issue is causing disruption to both supply and demand and, while we cannot quantify the real impact at this time, we're monitoring the situation closely and are working with our suppliers to minimize potential impacts.

We'll now move to slide three that shows our performance in the quarter in accordance with our new segmentation. I won't take you through every number but let me hit a few key points. In the

Intelligent Edge segment, we grew 4%. Our changes to North America sales leadership and go-to-market segmentation are paying off with double-digit growth in North America and 13% growth in overall wireless LAN product. While we continued to make relevant R&D and sales investments this year, we are also delivering significant improvement in profitability with operating margins of 9.7%, up 630 basis points year-over-year.

In Compute, revenue declined 15% this quarter due to the previously highlighted uneven demand environment, component supply constraints, and North American manufacturing site consolidation, yet we delivered a 9.5% operating profit margin, in-line with last year.

With respect to units excluding tier 1 and China, our units were up mid single-digits year-over-year and have also been growing sequentially since Q2 2019. In High Performance Compute and Mission Critical Systems, we grew revenue 6% that included our first full quarter contribution from Cray.

Our HPC business has been awarded over $2 billion of business that is expected to be delivered through fiscal year 2023. We will also optimize the Cray cost envelope and expect triple digit millions in annualized run rate cost synergies to be recognized by the end of the next fiscal year significantly adding to the operating profit and margins of HPC & MCS.

Within Storage, we made progress against a competitive backdrop, maintaining flat sequential revenues with notable strength in big data growing at 45% year-over-year and Hyperconverged Infrastructure growing at 6% year-over-year this quarter. Note that this is the first quarter we are reporting Hyperconverged Infrastructure in Storage, aligned to our peers.

In Advisory and Professional Services, we are reporting for the first time in our new segmentation revenue was flat and we significantly improved operating margins by 12.5 points year-over-year as we focus on eliminating unprofitable business.

Operational Services, which is included across Compute, HPC & MCS, and Storage orders were up 1% year-over-year and revenue was down 2%. Our services intensity, which is the ratio of attach revenue per unit, was up year-over-year again in every business segment this quarter with double-digit growth in HPC & MCS services intensity driven by Cray. This demonstrates that the underlying profitability of the units we sell and the attach rate continue to be robust.

Within HPE financial services, we expanded our net portfolio of assets, which was up 2% in constant currency this quarter with longer contract terms supporting GreenLake and we maintained a solid return on equity of approximately 15% again this quarter with bad debt loss ratio of 0.4%, which is best-in-class within this industry.

And while not shown on the slide, Communications and Media Solutions that is included in our Corporate Investment segment is a strategically important business to us, providing software and services capabilities to telco service providers. It is showing improved momentum. Orders in CMS were up 10% sequentially and revenue was up 2%, due to improved momentum of the telco software and services business.

Slide four shows the ARR slide that I discussed at our Securities Analyst Meeting in October 2019. Please reference the SAM presentation for a deep dive into what makes up the ARR. Our Q1 2020 ARR actuals came in at $511 million, a 19% year-over-year growth that accelerated from last quarter.

Our HPE Aruba Central platform is starting to gain traction with revenue growing triple digits year-over-year. We also continue to see strong growth in GreenLake services orders, which were up 48% year-over-year.

As we progress towards building our go-to-market as-a-service motion and remain focused on offering a full suite of differentiated solutions that can be consumed as-a-service, we are confident in achieving our ARR growth guidance of 30% to 40% compounded annual growth rate from fiscal year 2019 to fiscal year 2022.

Slide five, shows our EPS performance to-date, non-GAAP diluted net earnings per share of $0.44 in Q1 is in-line with our previously provided outlook of $0.42 to $0.46 due to disciplined execution, expanding gross margins, and favorable other income and expense. This represents year-over-year growth of 5%.

Also, please note our OI&E performance in Q1 of fiscal year 2020 does not change our fiscal year 2020 OI&E outlook. As we foreshadowed during last October's Securities Analyst Meeting, we continue to expect OI&E to be a $0.03 to $0.05 per share headwind in fiscal year 2020.

Turning to gross margins on slide six, we continue to deliver significant year-over-year gross margin expansion that was up 210 basis points year-over-year to 33.2% as we shifted to a higher margin offerings like the Intelligent Edge with Aruba Central, Hyperconverged Infrastructure, the addition of Cray, and commodity cost tailwinds.

Moving to slide seven, we have continued to improve operating profits since the beginning of Q1 of fiscal year 2018, while making strategic investments in R&D and sales to support long-term profitable growth. In Q1 of fiscal year 2020 we're now consolidating a full quarter of additional operating expenses from the Cray acquisition that will be optimized going forward.

Furthermore, given the additional uncertainty in the business environment introduced this quarter, we are taking near term actions that will enable us to protect and expand our profitability in fiscal year 2020, while continuing to make critical long-term investments. As Antonio mentioned, we will extend the HPE Next program into fiscal year 2021 and expect incremental savings while maintaining the original net cash impact.

Turning to cash flow on slide eight, operating cash flow declined with revenue $461 million year-over-year. Free cash flow for Q1 was in-line with normal seasonality at negative $185 million, in-line with the prior year, thanks to planned net CapEx benefits in the quarter.

Please remember, our normal seasonality is for cash to be used in the first half and then we generate significant amounts of free cash flow in the second half of the fiscal year.

Now, as a reminder on slide nine, we maintained a solid balance sheet with our cash flow generation, and we have a disciplined returns-based process for evaluating investments and capital returns.

We are committed to maintaining an investment grade credit rating that is evidenced by our current operating net cash position. Consistent with our capital return commitments, in Q1 we returned $360 million in the form of share repurchases and dividends.

As part of our capital allocation framework, we also target value enhancing acquisitions to improve our competitive positioning and to accelerate our strategy of pivoting to as-a-service that provides

us with higher levels of recurring revenue and profitability. As with any investment we consider, we follow a rigorous evaluation process, cognizant of size, valuation, and financial impact, such as accretion, dilution, and strategic fit.

Now, turning to our outlook on slide 10, as discussed, we are in an increasingly uneven business environment, but at this point we're comfortable maintaining our fiscal year 2020 non-GAAP EPS outlook of a $1.78 to a $1.94, given the cost actions we plan to take and the expected recovery of supply chain constraints over time.

However, there's still considerable uncertainty in the short term, due to the unknown potential impacts from the coronavirus. So, we're not in a position to provide our second quarter outlook.

From a cash flow perspective and given our negative cash conversion cycle, we expect some current year impact on working capital receivables with elongated sales cycles persisting and the need to build inventory levels due to the supply chain constraints.

Consequently, we feel it is prudent to revise our fiscal year 2020 free cash flow outlook from $1.9 billion to $2.1 billion to $1.6 billion to $1.8 billion. We remain committed to our previously announced capital management policy of returning 50% to 75% of free cash flow to shareholders and now expect to be at the higher end of that range for fiscal year 2020.

So overall, we continue to make progress against our strategic priorities within an uneven environment that introduced new challenges this quarter. We're taking the appropriate actions to navigate the near-term uncertainty while executing against our vision and strategy that is clearly resonating with customers.

We will continue to shift our portfolio to higher margin software-defined solutions and focus on delivering our edge to cloud platform, offering our full portfolio as-a-service by 2022. This will ultimately drive sustainable, profitable growth and shareholder returns for the long term.

Now with that, let’s open it up for questions. Thank you.

QUESTION AND ANSWER

Operator
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.

Our first question will come from Katy Huberty with Morgan Stanley. Please go ahead.

Katy Huberty
Thank you. Good afternoon. Tarek, how much do you think that temporary factors like component constraints, the supply chain disruption from coronavirus and the factory consolidation in North America had on total revenues? And then, as a follow-up, Antonio, given how important revenue growth is for stock price performance and valuation. Can you talk about the investments you are making, and the timeline investors should think about to return the company to growth and how dependent is that path on M&A? Thank you.

Tarek Robbiati

Okay. Good afternoon, Katy. Thank you for the question. With respect to how much those short-term disruptions have accounted for our revenue performance; I would say quite a lot. There are three things that affected our revenue performance. These are the macro environment softness. The second thing is supply chain constraints. And the third one is also the manufacturing node consolidation in North America. We've taken steps to address what's under our control. Nonetheless, coronavirus has affected the tail end of the quarter and injected a new degree of uncertainty. And when you look at the revenue performance of the company, most of the decline came in the Compute category that we referred to in our new segmentation and that decline has a lot to do with what you referred to from a supply chain standpoint.

Antonio Neri
Yes. Good afternoon Katy. And thanks for the question, and I will just add to Tarek that we feel pretty good about the recovery in the node consolidation that's under our control. All the other factors Tarek explained very well. In term of, when you think about investment long term, we have been very clear where we want to invest. The investment, obviously, is in Intelligent Edge. We see that as a next frontier, big opportunity for us. We continue to do so. And I have to say I'm incredibly pleased with the Q1 performance, because we said that business will return to growth and we show…we demonstrated that's the case. We outperformed the market and every single competitor there, and we are very, very pleased with the differentiation we have with our portfolio with higher margin.

So, for us, that's one area of investment, much of that growth has happened organically. But we always look for what makes sense for us in term of accretive addition, in term of intellectual property and talent, right, that we want to continue to expand that set of experience we delivered at the edge. And as I said in my opening remarks, we are on a journey to integrate 5G and mobile edge computing on a very robust cloud-based solution called HPE Aruba Central, which is all subscription based, and obviously we can deliver that through GreenLake.

Obviously, the other piece of this is what I call intellectual property to make our core business stronger. And that's all software defined on the core with some additional, call it, intellectual property in the silicon space. That's what the core of the Cray acquisition was all about. The Cray acquisition is all about software in a cloud native environment to run these big data-intensive workloads. And silicone, was all about that.

And as I think about the pivot as-a-service also we are looking for software that would make our as-a-service experience unique and differentiated in a true edge-to-cloud platform. And as I announced in my remarks, we introduced two key platforms. One is HPE GreenLake Central, which is the console, the control point for managing and deploying workloads at the edge in the core on off-premises. So, we add that managed services layer on top of that. And then, the container platform, which is a true cloud native environment, where you can run both legacy and cloud-based workloads. So those are the things we are doing, but I just want to emphasize, we have a very stringent and rigorous process here on return on invested capital. And I see as in M&A as one of the three levels to drive innovation. Organic is one aspect, partnership is the other one, and inorganic. And I'd say that the last 15 acquisitions, that I had been part of, it has been always in that vein, and that's our goal.

Katy Huberty
Thank you.

Andrew Simanek
Thank you. Katy. Can we go to the next question, please?

Operator
Our next question will come from Jeriel Ong with Deutsche Bank. Please go ahead.

Jeriel Ong
Awesome. Thank you, so much. I appreciate you giving me a chance to ask a question. To start off, is there any guidance for revenue for the year and, focusing on the quarter itself, could you quantify…or for the guided quarter, could you quantify maybe how much below seasonal you think these coronavirus impacts, and supply chain constraints could impact the next quarter?

Tarek Robbiati
Okay. So, let me start by the second part of your question, which is how much of an impact will the coronavirus have on our business? Well, first as we already flagged, the health and safety of our employees, customers and partners is our priority. And you know that out of abundance of caution for them, we've made the decision to cancel or postpone most of the HPE sponsored events through April. And unfortunately, this is also causing supply-and-demand disruptions and affecting our revenue profile. The outbreak at the end of January started to impact the component manufacturing and resulted in constrained supply and higher quarter-end backlogs worldwide. And we have been in constant contact with our suppliers and are establishing specific mitigation and recovery plans.

So, this is affecting our revenue profile for the full year. And this is why we're not guiding in the short-term and relative to what we said at SAM, where we were experiencing…we think we would be returning to growth in fiscal year 2020. I don't think that it is likely at this stage that we will be growing in fiscal year 2020 as a whole for the fiscal year, but we do anticipate recovery of those supply chain constraints over time and face easier comps during the course of the year.

Antonio Neri
I would like to add a couple of comments. One is on the coronavirus. Obviously, this is very fluid at this point in time, there is uncertainty. We have a daily process with each of our suppliers that we manage very, very tightly and some of those suppliers are depending on other suppliers, because as you can imagine, that supply chain is a little bit longer with the tier two, tier three suppliers that provide what I call low-level components to build what I call the printed circuit board. So, the PCIs or the PCBIs and that's a challenge we see today. And we see recovery, but obviously it's going to take time. And that's why Tarek said, we cannot provide right now a definite guidance. I think it would be not appropriate and that's why we prefer not to provide Q2, but because of the recovery is going to happen through the year, there we felt comfortable reaffirming the 2020 guidance.

If you remember, when we went to the Security Analyst Meeting in October, we said that we expect to grow the company on a three year basis, long-term plan of 1% to 3%. I think that this is still complete and intact because, as you can see, as we pivot the portfolio to higher value and higher margins at the same time, the pivot as-a-service, which is going extremely well, and then obviously, that Intelligent Edge business is growing. That’s how we think about the long-term growth in the right margin profile. Obviously, the Compute at this point in time was the challenge short-term. I don't think it was off compared to some of our peers. In fact, in some cases we did better than our peers, but that was a disappointment and obviously we need to stabilize it and manage it through the supply chain recovery.

Andrew Simanek
Thank you. Can we go to the next question, please?

Operator
Our next question will come from Tony Sacconaghi with Bernstein. Please go ahead.

Tony Sacconaghi
Yes, thank you. I have a question and a follow-up. First, I was wondering if you could provide book-to-bill information or backlog information for the Compute business for this year, relative to the end of Q1 last year. I think that would provide incremental confidence and insight into how much of this is component and your inability to fulfill versus how much of this is kind of a demand issue. So, a book-to-bill for Compute, this year versus last year, and/or backlog for compute this year versus last year. And I have a follow-up, please

Tarek Robbiati
Sure Tony. Good afternoon and thanks for the question. I don't have the book-to-bill, but I can tell you we entered Q2, which is the quarter we're in, with higher backlog than we anticipated and definitely it is more on the elevated side. And so that's true for Compute and as well a carryover for High Performance Compute, which are the core of that product, Tony, it's the legacy HPE Apollo.

So, we entered Q2 with a higher elevated backlog than we have seen. I don't see yet let and me qualify this, outside China, I haven't seen yet a significant impact on demand so far. Definitely in China, as you know, we have a different setup with our H3C partnership there. And you should expect a short-term impact in China. But right now, they are working through it. But I will say right now we haven't seen a significant impact. If anything, actually creates short-term opportunities. I can tell you because of the coronavirus we see customers coming to us and say, can you ship this product to take care of the fact that my employees are not going to be at work. We see some demand in specific areas of our workload optimized solutions.

And as I said in my opening remarks, we do have as awarded business, which obviously we have to build and ship, more than $2 billion in HPC business that we have to ship over the next several quarters in the next two years. And that business is doing very well from my advantage point, but it is obviously segregated in two different segments, Compute and on the other hand, HPC and Mission Critical...

Tony Sacconaghi
Okay. Thank you. If I could just follow-up, I'd love to get your impression of the stock. It's obviously very beaten down, and I'd like your view on that. And you've talked about your openness to doing acquisitions. And I'm wondering if you could clarify whether there's a size limit or whether you would go to $10 billion. But also, are there other structural moves that you would consider? So, would you consider taking on debt and aggressively repurchasing your own shares, given the valuation right now like HPQ has done? And would you consider other portfolio moves such as divesting businesses like, just for example, because it's small and orphaned A&PS or other businesses. So how…what do you think of the stock? How big the acquisition size? Would you think about debt repurchase? And how about divestment? Thank you.

Antonio Neri
Sure. And I'm going to start then I'm going to give it to Tarek. Let me talk about the stock. Listen, I think it is a disappointing kind of situation in my view. We are heavily discounted. There's no question about it. But think about the last nine quarters, Tony, and think about the gross margin expansion and the EPS expansion we have had. It is pretty remarkable. I mean, the last two

years we expanded the margins every single quarter and we have expanded EPS every single quarter.

So, my vantage point, we have done the right things. We have made the company leaner, meaner, and at the same time, we have taken big, big, big challenges. And we have managed it through. So, I think for us it's to continue to focus on the areas where we see the opportunity to compete and win in higher margins. But obviously, the stock also, thinking about long-term growth and I understand that and obviously a big component of that is our Compute business, but in the end, I think the stock is heavily discounted. I'm disappointed with that.

On the M&A, we have been very clear since day one that we look at assets that they are accessible, that generally are accretive, or we can manage the dilution very quickly, but ultimately it has to have strategic fit in the context of our strategy, obviously, whether it is the edge-to-cloud architecture and pivoting as-a-service.

I think the assets we have acquired makes complete sense from that vantage point, and we have delivered strong results. Size is important, but I will say it's more strategic fit and obviously the return on that investment capital, which we have incredible strong discipline and where we have demonstrated at over the last two years. And so, maybe I will pass it now to Tarek, because you asked the question about taking debt and buying stock and so forth.

Tarek Robbiati
Yes. So, Tony, I would say, Antonio answered the question on the stock. I would simply point to you at the performance of the value as part of our business, the Intelligent Edge, which has outperformed the sector quite substantially this quarter. What's the value of that? If you look at our storage business, which has done better than most other players in the market and is of the same size as a very large pure-play listed company, what's the value of that? And if you look at our HPC & MCS business and the $2 billion of backlog contracted revenues that would come in, what's the value of that? And then you have to look at other players in the sector and compare our Compute business to them and see that also for those players that Compute business is valued negatively from an equity standpoint, but it does generate cash and we have to figure that out.

Finally, let me finish by saying H3C, the put option, what's the value of that? It's a listed company and it's pretty substantial. So, I'll let you conclude whether the stock is beaten down or not and how much is beaten down and you probably in your own question you have the answer. Well, expected acquisitions…sorry, go ahead.

Tony Sacconaghi
No, I was just going to say, you basically said I think it's really beaten down, especially on some of the parts. So then are you or why wouldn't you consider much more aggressively repurchasing your own shares at these levels?

Tarek Robbiati
So, the thing that we…let me just finish up answering the other part and I'll come back to your question on buying share. With respect to acquisitions, Antonio answered very, very clearly. We remain disciplined in that field, when we're not going to look at acquisitions that don't fit our investment criteria from an accretion dilutions standpoint. It's very, very important. We do that. A&PS, specifically for A&PS, it's a very strategic business that pulls a lot of revenue and profits in other parts of the organization and is essential for enabling the as-a-service pivot.

Now coming back on to your question with respect to aggressive buyback, we did in the past two years execute a $7 billion capital return program to shareholders. We returned $2.9 billion by way of dividends and $4.1 billion by way of buybacks. And what we did flag at SAM is the fact that we are going to continue to return capital to shareholders in line with our free cash flow generation capacity. We're not going to deviate from this, because it's important that we continue to think about the long-term value of those businesses and each one of those businesses has its own investment profile and needs to be therefore catered for.

Tony Sacconaghi
Thank you.

Antonio Neri
Thanks, Tony.

Andrew Simanek
Thanks, Tony. Can we go to the next question, please?

Operator
Our next question will come from Shannon Cross with Cross Research. Please go ahead.

Shannon Cross
Thank you very much for taking the question. I wanted to look more at your cost cutting actions. I think you talked about taking actions during the current quarter, which maybe curtailing travel, which obviously would save money, but more importantly how are you thinking about the expansion of Next? Is this sort of a reevaluation of your cost base? Or is it more sort of a continuation of your usual productivity actions? And then, I have a follow-up. Thank you.

Tarek Robbiati
Sure. So, thank you Shannon for this question. When first and foremost, you may recall, when I joined HPE 14 months ago, I used the expression at SAM in 2018 that looking at our cost structure was akin to a fitness exercise. And it's always important that we look at our cost structure based on the revenue profile that we have and it's no different right now. Specifically, to HPE Next, we are continuing the implementation of the program in that context where we have to align our cost structure to the new business climate that exists. We're not announcing a new restructuring plan. And what is happening is that, through the implementation of the new segmentation, we have identified new savings opportunities in each of the businesses and we'll continue to streamline our operations in that context.

Antonio Neri
I would say, Shannon, a couple of things. So, I think that what we have done in the last two years give us insights on how we can streamline our operations and be even more agile and focused on everything we do. And as you recall, the HPE Next was really transformative from the process standpoint as well as from the IT perspective. And I will say for the vast majority, everything was executed flawlessly, and we have delivered the results with a gross margin expansion you see. As we implemented this new segmentation, now we can see through even better visibility on what else we can go and do.

And as Tarek just said it, right, the reality is you never stop focusing on improving your operations and because the HPE Next actually at the core was a cultural transformation, it give us the ability now to take further actions, which are actually I will argue timely considering the uncertainty we

live in. But it's to do the hard things now as these things recover to come on the other end even stronger than before.

On the short-term actions, I think first we have to protect our employees, first and foremost, I think, it's important. And that was the first step. And then, obviously, that comes with the benefits and the savings. But I want to be clear, this is all about protecting our employees to make sure they don't get exposed to things they don't need to.

Shannon Cross
Thank you. And then can you talk a little bit about what you've seen just in the last couple of weeks in terms of production capability or capacity and things coming online. I'm just curious, because some of the other companies in the space have started to mention that they're seeing some improvement in the supply chain. Again, this is more on the China side, but just in terms of availability of components in that. And one we talk to has even indicated that almost on a daily basis, things were getting better. So, I'm just curious if you can talk at all about near-term trends.

Antonio Neri
Yes, now, that's correct. We see kind of the same thing. Obviously, some company has been aligned for some time and they have been recovering on a daily basis, the output of their facilities or their capacity. Obviously, the biggest complaint they had at the time was labor, because obviously, depending on the region within China, but eventually it became the entire China for the most part is the health measures and certifications that they have to go through. But in general, I will say, it has progressed every single day and, whether it is people coming online or people improving the output of what they were already doing. And so that's progressing.

And so, you have to take it day-by-day. And obviously, what we're doing is, because we have a global supply chain here…is China is one aspect, but also how we manage inventory and how we manage the distribution of those…all of those in a way we can maximize the return while these things gets back to normal. That's how we are managing it. And to be honest, we have a very stringent process with war rooms and talking to suppliers every single day. I personally have talked to at least 50 of them myself, and I have direct contact with each of them.

Shannon Cross
Thank you.

Andrew Simanek
Thank you, Shannon. Can we go to the next question, please?

Operator
Our next question will come from Wamsi Mohan with Bank of America Merrill Lynch. Please go ahead.

Wamsi Mohan
Yes. Thank you. Your free cash flow guidance came down, but EPS did not. I was wondering, are you still expecting the same operating profit dollars? Or are there other items, some benefits below the line that are contemplated within your guidance? And I have a follow-up.

Tarek Robbiati
Yes, thank you, Wamsi. So, you remember last year, this time of the year, we did say that from a free cash flow standpoint, working capital would be a contributor to cash. And that is what happened last year. This year, we have attained the point where our cash conversion cycle is

negative. And whilst we do deliver the EPS guide and we confirmed it, per Antonio, the drop in revenue will inevitably have a drag on the free cash flow generation. That is because we have a negative free cash flow cycle. So the way cash tracks earnings is a combination of what happens in the P&L at EPS level, but also the working capital components that comes with the P&L and the revenue from the accounts receivable side, and also the fact that we need to build inventory to be able to cater for the supply chain shortages that we explained. That is what is behind the difference between the P&L EPS performance and the free cash flow guide that we put forward.

Antonio Neri
And I will say in 2020, obviously it's a timing issue as we recover the supply chain, and that is a timing from the…when we can build and ship these products, obviously, and also the fact that we have to rebuild some of the inventory, because as the operations in China and other parts of the world maybe were impacted, we had to manage that inventory and now we have to build it back over time.

Wamsi Mohan
Okay. Thank you. Antonio, you commented on sort of the uncertainty surrounding 2Q, but you're also seen to be confident on the fiscal year guide. I understand HPE Next is under your control. But what gives you confidence that this demand comes back? It's clear that things in China are improving, but when you sort of think about the demand environment globally, what gives you confidence that the demand is going to come back in the second half, because that's what it seems implicitly what is embedded in your full year guide? Thank you.

Antonio Neri
Yes, I mean, first, let's start with some of the businesses I have reported earlier, and Tarek provided detail. Obviously, the Intelligent Edge, we see continued momentum. That is continuing right now as we speak. We feel pretty good about that. Much of the supply chain is not gated in China for the Intelligent Edge, so that's positive news. Then obviously, on high performance computing, that demand continues to be solid. And we have a very interesting pipeline ahead of us with a unique differentiated portfolio. So, the need for processing data through AI, machine learning, big data intensive workloads continue to be very high. That's not stopping.

As we think about these new storage platforms, particularly what I call intelligent data platform, the data growth requires that that data gets stored and gets managed and ultimately insights are extracted from it. That's positive as well.

Right now, as I said earlier, as we went through Q2, we enter with a sizable backlog, because we couldn't ship it in Q1, everything we wanted. And at the same time, we haven't seen yet outside China a significant impact, but obviously as we think about the second back of the year here, obviously we expect things to return to a level of normalcy that eventually will allows us to continue to progress against that. That's how I see it right now. And because of everything we do both from a mix perspective with the pivot obviously as-a-service, which is a long-term opportunity and growing and the fact we're taking our own actions here with HPE Next and other ones, that’s where at this point in time, we felt comfortable in affirming the original guidance that we provided here on EPS. So, we felt prudent to adjust the cash flow for the dynamics, Tarek explained earlier.

Wamsi Mohan
Perfect. Okay. Thank you.

Andrew Simanek
Perfect. Thank you, Wamsi. I think we have time for one last question, please.

Operator
Our final question will come from Simon Leopold with Raymond James. Please go ahead.

Simon Leopold
Thanks for taking the question. I've got two. One is probably really simple, so I'll ask that one first and then the follow-up. What are your expectations for the full year's net CapEx? If you could answer that and then I've got a follow-up.

Tarek Robbiati
Look, net CapEx for this year is not a particularly large number. In this first half of the year, we have benefited from in plan sales that have reduced our overall CapEx consumption. And we think that from a CapEx standpoint, we're in line with prior years. I don't see beyond the first quarter performance, a significant uptick in CapEx this year.

Antonio Neri
We don't have any specific CapEx expenditures that they are extraordinary from what we had seen before.

Simon Leopold
Okay. And then the other one I wanted to see if you could give us some better insight is to understand how much money you would be able to borrow say for acquisitions or other purposes yet still maintain your investment grade credit rating. I believe that's important to you. So just I want to get a better understanding of what the sort of maximum borrowing could be. Thank you.

Tarek Robbiati
Well, it really depends on what you borrow the money for to some extent, right. And that's a question. But if you really want to look at how we maintain our investment grade rating and what would be our borrowing capacity maintaining that investment grade rating, it's probably around the $5 billion mark.

Antonio Neri
But I want to make sure that one thing is clear, right. We are committed to maintain our credit rating.

Simon Leopold
Thank you very much.

Andrew Simanek
Great. Thank you, Simon. I think with that we can close down the call.

CONCLUSION

Antonio Neri
Alright, thank you.

Andrew Simanek
Thank you everyone for joining us.

Operator
Ladies and gentlemen, this concludes our call for today. Thank you.