

Hewlett Packard Enterprise

First Quarter 2023 Earnings Conference Call

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CORPORATE PARTICIPANTS

Antonio Neri - *President, Chief Executive Officer*

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

Jeff Kvaal - *Senior Director, Investor Relations*

PRESENTATION

Operator

Good afternoon and welcome to the First Quarter 2023 Hewlett Packard Enterprise Earnings Conference Call. My name is Anthony, and I'll 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, Jeff Kvaal, Senior Director of Investor Relations. Please proceed.

Jeff Kvaal

Thank you, Anthony and good afternoon, good evening everyone. I'm Jeff Kvaal, and I'm head of Investor Relations for Hewlett Packard Enterprise. I'd like to welcome you to our fiscal 2022 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.

Let me remind you that this call is being webcast. A replay of the webcast will be available shortly after the call concludes. We have posted the press release and the slide presentation accompanying the release on our HPE IR web page. Elements of the financial information referenced on the call are forward-looking and are based on our best view of the world and our businesses as we see them today. HPE assumes no obligation and does not intend to update such forward-looking statements.

We also note that the financial information discussed on this call reflects estimates based on the 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, 2023. For more detailed information, please see the disclaimers on the earnings materials related to forward-looking statements that involve risks, uncertainties and assumptions. Please refer to HPE's filings with the SEC for a discussion of these risks.

For financial information we've 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 otherwise noted, are presented on a year-over-year basis and are adjusted to exclude the impact of currency. Finally, after Antonio provides high-level remarks, Tarek will be referencing the slides and our earnings presentation throughout his prepared remarks. And with that, let me turn it to you, Antonio.

Antonio Neri

Well, thanks Jeff, and good afternoon everyone. Thank you for joining our earnings call. We begin our fiscal year 2023 from a position of great strength after delivering an outstanding 2022 fourth quarter.

I am extremely pleased with how we leveraged that strength to achieve impressive results in Q1. HPE posted a record set in first quarter performance, extending our track record of consistency fulfilling our financial commitments. We generated our highest first quarter revenue since 2016 and our best ever non-GAAP operating profit margin.

Our focus on growth opportunities and pricing discipline produced our highest ever non-GAAP diluted net earnings per share. Powered by our market-leading hybrid cloud platform, HPE GreenLake, we unlocked an impressive \$1 billion in annualized revenue run rate or ARR for the first time.

Our results show the relevance of our strategy that addresses megatrends around Edge, cloud and AI reshaping our industry, the transformation of our industry leading portfolio and the outstanding execution of our team. In the first quarter, total HPE revenue climbed 18% to \$7.8 billion, significantly above the high end of our outlook. We once again expanded non-GAAP operating margin this time to a record 11.8%, up 80 basis points year-over-year.

Non-GAAP diluted net earnings per share increased 19% year-over-year to \$0.63. Free cash flow was negative \$1.3 billion, reflecting working capital needs in a quarter where we typically see use of cash. Our Q1 performance and the size of our order book position us well for fiscal year 2023. Our quarterly results, combined with confidence in our strategy and execution, have led us to raise our revenue and EPS guidance for the full fiscal year. Tarek will provide more details in his remarks.

From a macro perspective, the supply chain challenges we faced during several quarters continue to ease, and we expect more of that throughout fiscal year 2023. As we mentioned at the close of fiscal year 2022, we do not anticipate all supply shortages coming to an end, but we do expect supply availability to continue to improve. Our order book at the start of Q1 was larger than it was a year ago. And as we exit that quarter, it is more than twice the size of normalized historical levels.

Our Intelligent Edge, HPC and AI and other As-a-Service order books continue to stand at extremely elevated levels. Against today's macroeconomic backdrop, demand for our solutions continue, though it is uneven across our portfolio. We also see more elongated sell cycles, specifically in compute that we have seen in recent quarters. We have responded decisively to demand in the market, working to win deals across all geographies and all parts of our portfolio.

The traction of our portfolio is the result of our winning strategy, aligned to major market trends around the Edge, cloud and AI. We continue to anticipate what comes next for our customers and invest in innovation to address the data first modernization needs with an unmatched set of Edge to cloud solutions.

In addition to driving impressive organic innovation across our portfolio, we continue to be opportunistic in considering strategic acquisitions and partnerships that enhance what we can offer to our customers. Today, we announced our agreement to acquire cloud security provider Axis Security, which will help fortify network security and strengthen our Secure Access Service Edge or SASE solutions as we anticipate further customer demand for enhanced connectivity to our HPE Aruba Intelligent Edge solutions.

Last week, we also announced our purchase of Athonet, which strengthened our private networking capabilities to help enterprises and telcos accelerate 5G deployments. Through these acquisitions, we are creating one of the most complete cloud portfolios in private 5G and wireless connectivity, areas we have identified for growth in coming years. These new private 5G capabilities will be integrated into our HPE GreenLake platform, enabling customers to combine their WiFi and private 5G into one subscription they can scale according to demand.

Earlier in the first quarter, we also purchased technology from two companies that enhance our cloud compute and AI offerings. Next quarter, we will begin selling scalable compute software technologies from Tidal Scale, introducing additional choice points for customers to meet their compute and data-intensive workload needs.

We will also integrate the Pachyderm reproducible AI software with our supercomputing AI solutions to further expand our AI at scale capabilities. We will continue to assess organic and inorganic investments that improve our competitive position in growth markets while driving higher level of recurring revenue and profitability. As always, we follow a disciplined return-based framework to build on our track record of creating sustainable long-term value for shareholders.

Since we began the transformation of our business in 2019 to become the edge to cloud company, we have consistently grown our As-a-Service business, underpinned by the HPE GreenLake platform. The relevance of HPE GreenLake with customers, combined with our disciplined execution, has propelled both AI and our as-a-Service total contract value higher.

Over the last two years, we have more than doubled our As-a-Service total contract value, reaching nearly \$10 billion through the end of this quarter. These milestones prove the momentum in our transformation. During the first quarter, we once again increased our new HPE GreenLake logos, growing our customer base by 7%, while As-a-Service order this quarter declined 20% year-over-year, it is important to keep in mind that the order figure is compared to prior year growth of a record 136%.

One HPE GreenLake customer we recently highlighted is the 2023 Ryder Cup, which announced HPE will deliver an intelligent, secure and flexible high-performance network to our platform at the September 2023 golf event in Rome. Our platform will enable the Ryder Cup to deliver the tournament as a service in a sustainable cost-efficient way while significantly enhancing the spectator experience and engagement. We have continued our investment in HPE GreenLake, expanding our cloud services portfolio and partner ecosystem.

In December, at our HPE Discover Frankfurt customer event in Germany, we announced our latest enhancements and the new cloud platform services capabilities in the data analytics, developer and sustainability areas. Our HPE GreenLake platform continues to attract business and drive performance across the portfolio. In every one of our key segments during the first quarter, we produced more revenues as well as positive operating profit.

Let me provide you a few highlights. In our Intelligent Edge segment, revenue increased 31% year-over-year. We continue to see customers switch to our HPE Aruba technology from other vendors. We provide a single AI-driven cloud management experience, which is now part of HPE GreenLake platform with easy-of-use improving cost benefits. Year-over-year revenue growth was even higher in our HPC and AI segment, up 37% as we book revenue associated with Frontier, the world's first Exascale system.

HPE is the clear market leader and has significant growth opportunities as enterprises scale AI models. AI will transform the IT landscape in the coming years and is a generational technology shift like web, mobile and cloud that have the potential to disrupt existing business models. Supercomputing will be essential to enabling this disruption.

For example, building a viable generative large language model for search would require a supercomputer to run the model continuously to stay current and improve accuracy. Our HPC

and AI business has strong IP in the case of experience that give HPE a competitive advantage in building large computing systems, which are required to increase commercial adoption of AI models globally.

We recognize AI will become the dominant supercomputing workload, when we acquired the market leader Cray in 2019. And we continue to invest in key technology innovations that will enable these AI models at scale. Key examples are our acquisition of Determined AI in 2021 and Pachyderm early this year. While either unique and differentiated software to help our customer strength AI models and automate data pipelines.

Customer recognized this leadership. For example, Aleph Alpha, a German startup building a commercial large language model has turned to HPE. We're also working with customers across industry verticals such as life sciences, aerospace to enable new breakthroughs with AI. In the quarters ahead, we anticipate sharing more news on how we are scaling in this market and attracting new customers.

I'm also pleased with the strong and steady performance of HPE Financial Services, which grew revenue 8% and financing volumes 21% year-over-year. Last month, we announced the retirement of our long-standing leader of this business, Earl Rotman, and the promotion of Gerri Gold to take the helm and further accelerate the business momentum.

Gerri and her team recently launched a special financing program for customers who score high in ESG, and we are seeing great customer and partner response already. I am very proud of how our HPE team members have executed to achieve this quarter's exceptional performance, especially given the uneven macro environment.

We have kicked off fiscal year 2023 with another set of standout results, giving us the confidence to raise our revenue and non-GAAP earnings per share guidance for the full fiscal year. Our customers have responded to the hybrid cloud value proposition we uniquely provide as they seek better ways to drive value from data from a cloud. We are attracting more customers and executing with discipline.

As we look forward, we remain laser-focused on executing our winning strategy, which is delivering unmatched innovation and significant results for our customers and shareholders. We are confident in our strategy and execution for the long term.

Let me now ask Tarek to give details on our business segments and greater visibility into our updated financial outlook. So, Tarek, over to you.

Tarek Robbiati

Thank you very much, Antonio. Q1 2023 was, as Antonio said, a record quarter for HPE. As usual, I will reference slides from earnings presentation to guide you through our performance. Antonio discussed key highlights for Q1 2023 on slide four.

Let me discuss our Q1 performance details, starting with slide five. We are very pleased that the execution of our strategy has driven record quarterly results in terms of revenue, non-GAAP gross margin, non-GAAP operating margin and non-GAAP EPS for a first quarter of a financial year. These and other records I referenced are primarily since we reset our strategy with our 2017 spin-off transactions.

Notably, revenues grew year-over-year across all our business segments, save for corporate in Q1 2023, as we benefited from improvements in the supply environment. Our supply chain execution is solid, we have very strong momentum, thanks to our substantial order book and our investments are bearing fruit, and we are gaining share in specific market segments.

In short, our strategy is working and working really well. Having said so, while we are optimistic about our fiscal year 2023, we are all realistic. Overall, we have experienced above-trend demand through much of the past two years as attested by our growing order book over the fiscal year 2022 period. And now market demand has shifted from being steady across our portfolio to being uneven over the course of Q1 2023. More specifically, deal velocity for Compute has slowed as customers digest the investments of the past two years, though demand for our storage and HPC & AI solutions is holding and demand for our Edge solutions remains healthy.

In that context, we are taking action to maintain our momentum for the second half of 2023 and fiscal year 2024. We intend to further our investments in software and services in all our business units including in our HPE GreenLake edge-to-cloud platform, HPC AI, storage and Edge to extend our share gains across our segments, all while retaining our cost discipline and productivity focus.

We delivered Q1 revenue of \$7.8 billion, which equates to a robust 12% year-over-year growth and 18% in constant currency despite our exit from Russia and Belarus in Q2 2022. We did not experience a typical seasonal decline between Q4 and Q1, thanks to excellent supply chain execution on our large order book. Each of our segments, excluding only our corporate segment, grew revenue at least 8% in constant currency. This revenue performance was well above our prior guidance for Q1 of \$7.2 (billion) to \$7.6 billion and represented a record Q1 revenue level.

We benefited from improvements in the supply environment, particularly in our Compute segments. This allowed us to execute against our order book, which our customers greatly appreciated. The delivery times of our products and services across our portfolio are now almost back to pre-pandemic levels. Yet we continue to have more progress to make in supply chain productivity as our order book entering Q2 2023 is more than twice normal level across our company.

The combination of our large order book and improved supply environment gives us confidence that we can grow revenues well above the previously communicated guidance of 2% to 4% revenue growth in constant currency for fiscal year 2023. More on that later.

As a result, we also remain confident in the longer term 2% to 4% revenue CAGR outlook over the fiscal year 2022 to fiscal year 2025 period, we provided at our 2022 Securities Analyst Meeting last October.

Our non-GAAP gross margin reached a Q1 record of 34.2%. This is up 30 basis points year-over-year and 110 basis points sequentially. Our margin structure has benefited from pricing actions we have taken over the course of the pandemic, combined with the beginnings of declines in commodities and logistics costs.

Over the long term, our margin structure will continue to benefit as we continue to shift our mix of business to higher margin software-intensive As-a-Service offerings. Our non-GAAP operating margins reached a record high 11.8%. This is 80 basis points ahead of Q1 2022 and

30 basis points higher than Q4 2022. While strong revenue growth and gross margin performance are key drivers, this result would not have been possible without the strategic actions Antonio and I took in fiscal year 2020 to reallocate resources and optimize our cost structure.

As mentioned during our last earnings call, Antonio and I remain determined to maintain our focus on productivity. Our top line and margin strength in Q1 translated to GAAP diluted net EPS of \$0.38 and non-GAAP diluted net EPS of \$0.63. Non-GAAP diluted net EPS easily exceeded our guidance range of \$0.50 to \$0.58 and was another company record.

Our Q1 2023 free cash flow was negative \$1.3 billion. We typically have seasonal outflows in our Q1. We will discuss cash flow in more detail in a moment, but having said that, we remain on track to generate between \$1.9 (billion) and \$2.1 billion in free cash flow in fiscal year 2023.

Finally, we are continuing to return substantial capital to our shareholders. We paid \$156 million in dividends this quarter and repurchased \$73 million in stock. We intend to buy back at least \$500 million worth of shares in fiscal year 2023, just like we did in fiscal year 2022.

Turning on to our As-a-Service business performance. We are very pleased to announce our ARR surpassed \$1 billion in Q1 2023. This is an important milestone for our business that reflects that our As-a-Service strategy is working. The supply chain challenges have slowed our ARR growth in prior quarters. The benefits of easing supply challenges are beginning to appear in our results as ARR growth in constant currency accelerated from 25% in Q4 2022 to 31% in Q1 2023. We expect further acceleration through fiscal year 2023 as improving supply allows us to expedite delivery of As-a-Service solutions to our customers.

Our As-a-Service orders decline of 20% in Q1 is a function of a difficult compared to Q1 2022, in which orders grew 136% on strength from several large deals, including a large public cloud customer. We are comfortable with our robust pipeline of As-a-Service business. We base this confidence on our 68% order growth in fiscal year 2022, the number of deals currently pending acceptance and our current view of the sales funnel.

We, therefore, retain our three-year ARR target of 35% to 45% CAGR from fiscal year 2022 to fiscal year 2025. Most importantly, we continue to make our As-a-Service business more valuable with a growing mix of higher-margin software and services recurring revenue.

In Q1 2023, our mix of software and services increased another 150 basis points year-over-year to 65%, thanks to our cloud and SaaS offerings particularly in Edge and storage.

Let's now turn to our segment highlights on the next slide. I would like to remind you that all revenue growth rates on this slide are in constant currency. In the intelligent Edge, we delivered a second consecutive record revenue quarter and surpassed the \$1 billion revenue milestone for the first time. We grew our revenue 31% year-over-year. We are outgrowing our main competitors and are taking share with our combination of wireless LAN, enterprise switching and SD-WAN solutions including in some of the largest enterprise customers.

Customers are increasingly adopting our software-centric solutions such as our Edge Service Platform and automation suite. Our operating margin of 21.9% was up 450 basis points annually and 860 basis points sequentially. Repetitive income scale and our prior price increases have worked through our order book.

We are very pleased that our Edge business has exceeded the Rule of 40 this quarter and feel very optimistic about the prospects of our Aruba business in fiscal year '23 and beyond given its substantial order book underpinned by a superior platform-based SaaS offering, retained confidence in our long-term targets of mid-teens revenue growth and mid-20% operating margins. In HPC and AI, revenue grew 37% year-over-year.

We successfully closed the balance of the Frontier deal in Q1 which contributed to the strength of this business in Q1, '23. While the segment is also now benefitting from easing supply chain, the lumpiness and long lead times of this business mean that operating margins will continue to fluctuate.

As Antonio mentioned, we have been thinking strategically about and investing behind artificial intelligence for many years. This is true both organically and inorganically. The emergence of large language models such as ChatGPT and Bard and Generative AI, some of which run in our systems, has prompted many questions from our customer base. We believe AI at scale is a high-growth market and that the building and refinement of AI models will require unique computational capabilities that our Cray supercomputers and HPC & AI solutions are extremely well positioned to enable. We intend to invest organically and inorganically as attested by our acquisition of Pachyderm to fully grasp this opportunity.

With regard to storage, we are pleased to report 10% annual growth where we are bolstering our portfolio to grow market share. HPE Alletra remains one of our fastest-growing new products introductions ever and grew well above triple digits in Q1. HPE Alletra contributed to double-digit growth in our own IP products which is driving a mix shift to higher margin software intensive as a service revenue. We continue to invest in R&D for our own IP products in this business unit and as a result, our Q1 operating margin of 12% is down 190 basis points year-over-year.

Compute revenues grew 19% year-over-year to \$3.5 billion. The segment benefited from the multi-sourcing and the amount of ceiling initiatives we have discussed in prior calls as well as steadily improving supply availability. Our dynamic pricing strategy has helped us navigate a volatile supply climate while driving industry-leading gross margins. Our compute operating margin of 17.6% exceeded our long-term outlook of 11% to 13% for the fifth consecutive quarter which attests to our best-in-class performance. We do believe our compute operating margins are peaking and should gradually return to our target range of 11 to 13%. While we are seeing commodities cost decreasing, leading to increased competitive price pressure, we have for the first time three concurrent and differentiated platforms being sold in the market, Gen10, Gen10 Plus and Gen11 which would allow a gradual management of pricing and margins over time.

In our Pointnext operational services business, combined with storage services, orders declined mid-to-high single digits and revenues were flat year-over-year driven by uneven demand. As you know, this is a key component of recurring revenues and profit from each of our segments. Finally, HPE Financial Services revenues rose 8% year-over-year and financing volume of \$1.6 billion grew 21% in constant currency.

Our HPEFS operating margins fell 300 basis points year-over-year due to the higher interest rate climate that we will gradually offset over time through pricing. Time and time again, our HPEFS business has proven resilient in a downturn thanks to the quality of the underwriting of the book of business. Throughout the pandemic, I would like to remind you our annual loss ratio never exceeded 1%. Our loss ratio is back to pre-pandemic levels of approximately 50 basis points.

Slide eight highlights our revenue and non-GAAP diluted net EPS performance. We are very pleased that the progress we are making against our Edge-to-cloud strategy is evidenced in the financial results we have delivered on both the top and bottom lines. We have grown both our revenue and non-GAAP-diluted net EPS to record or near-record levels in Q1, '23. This illustrates not only the commercial success of our products in the marketplace, but also our ability to generate healthy margins.

I am particularly pleased to see that our focus on supply chain execution has enabled the attainment of record revenues despite a substantial year-over-year headwind from foreign exchange rates that impacted revenue growth by 550 basis points in Q1, '23.

Slide nine illustrates the progress we have made in our gross margin structure. Our Q1, '23, non-GAAP gross margin is up 30 basis points year-over-year. We generated \$2.7 billion in gross profit in Q1, '23 which is yet another quarterly record. Our gross profit and margin are testament to the success of our strategic pricing actions through the period of supply challenges in fiscal year '20 to fiscal year '22.

It is also illustrative of the long-term favorable mix shift we are driving. Despite a strong compute quarter, our revenue mix of compute at 44% was flat year-over-year. This illustrates that we have a larger revenue base as our higher margin segments are growing rapidly and our As-a-Service strategy is gaining momentum.

Slide 10 illustrates our non-GAAP operating margins progress which reached 11.8% in Q1, '23. This is up 30 basis points sequentially and 80 basis points year-over-year. It is also a record quarterly non-GAAP operating margin for the company.

Our very strong Q1 revenue performance and our resilient gross margins are the leading contributors to the operating margin expansion. Unlike many tech companies that have announced layoffs recently, we have strong momentum at HPE with a combination of our improved cost structure, substantial order book and outstanding execution delivering profitable growth that is increasingly recurring at higher margins as our As-a-Service transformation continues to unfold. Again, let me reiterate that Antonio and I are determined to maintain this focus on profitable growth and productivity for the future.

Let's now turn to discuss H3C. As you know, we have chosen to exercise our put options on our shares in H3C. We took this decision after carefully weighing the financial implications of remaining in the joint venture with the risk-reward profile of exercising the put.

We are confident that we have made the decision that is in the best interest of our shareholders. HPE and our partner Unisplendour continue to have constructive discussions to reach agreement on the determination of the final purchase price of HPE shares in H3C and enter into a share purchase agreement.

We will keep you updated. Please keep in mind that our decision to exercise the put is distinct from the commercial agreements with H3C. We intend to continue to do business in China through both our direct sales and through H3C and we remain committed to serving our customers in China.

I would like to remind you that we will continue to recognize the value of the dividends we received from H3C in our financials until the transaction is complete and I am happy to report H3C results remains healthy despite uncertainty in the Chinese economy.

Our first fiscal year from a cash-flow perspective is typically a down quarter for cash flow. In Q1, '23, we had outflows of \$800 million in cash flow from operations and \$1.3 billion in free cash flow. Working capital was a use of cash due to timing of receipts, payments and continued investments in inventory which has driven our cash flow conversion cycle from a negative 14 days in Q4 to a positive 15 days in Q1, '23.

More specifically, our accounts payable balance was reduced by \$2.2 billion quarter-over-quarter and was a main driver for negative operating cash flow and affected our cash flow conversion cycle. Also, we have made significant investment in HBFS volumes to drive future growth in subsequent quarters. We expect to generate significant free cash flow in the remainder of fiscal year '23 and reiterate our guidance of \$1.9 (billion) to \$2.1 billion in free cash flow for the full year.

Now let's turn to our outlook slide on slide 13. As we have mentioned, demand for our products and services was more uneven in Q1 '23 across our business than it was in Q4 '22. Having said that, we also believe our portfolio differentiation will continue to drive market share gains and are entering Q2, '23 with a substantial order book relative to pre-pandemic levels.

We had strong momentum in Q1, '23 and we are now turning our focus to invest in sustaining that momentum in the second half of '23 and fiscal year '24 in a context of continuous macroeconomic uncertainty. Let me reiterate that our guidance incorporates our current thinking on the macroeconomic picture, inflationary pressure, our exit from Russia and Belarus in '22 and foreign exchange risk. I would like to remind you that approximately 50% of our revenue is generated in foreign currencies.

For Q2 2023, we expect revenues in the range of \$7.1 (billion) to \$7.5 billion. At a mid-point of the range, this represents 9% year-over-year growth in reported dollars. We expect GAAP diluted net EPS of \$0.27 to \$0.35 and non-GAAP diluted net EPS of \$0.44 to \$0.52. This outlook assumes the current level of demand we have been experiencing remain unchanged, and that we continue to make progress on the delivery of our order book.

To sum it up, I am very pleased with our Q1 results and guidance for Q2. We also understand some of our end markets are likely to remain uneven in the near-term. We had indicated at our last earnings announcements that our financial performance in fiscal year 2023 is likely to be more weighted to the first half of the year than is typical.

Given the strong Q1 performance, momentum and substantial order book we continue to have, we are lifting our full year guidance accordingly. We are now targeting 5% to 7% revenue growth adjusted for currency, which is at the midpoint, twice our prior revenue growth guidance, non-GAAP operating profit growth of 5% to 6%, GAAP diluted net EPS of \$1.40 to \$1.48, non-GAAP diluted net EPS of \$2.02 to \$2.10 and free cash flow of \$1.9 (billion) to \$2.1 billion.

Specifically for OI&E, we benefited in Q1 2023 from one-off foreign exchange gains that accounted for \$0.02 to \$0.03 per share. These are unlikely to repeat in the rest of the fiscal year. Given the high interest rate environment is expected to remain unchanged, we expect OI&E to be an expense of \$20 (million) to \$40 million on a full year basis. This explains our

fiscal year 2023 EPS guidance range of \$2.02 to \$2.10, which incorporates \$0.06 of the \$0.09 beat in Q1 2023.

In terms of capital returns, we will return approximately 60% of free cash flow to shareholders via dividends and repurchases. We are maintaining our dividend and expect to repurchase at least \$500 million worth of shares in fiscal year 2023.

So, to conclude, our results speak for themselves, and we continue to execute better than the competition. While many tech companies are playing defense with layoffs, we see fiscal year 2023 as an opportunity to accelerate the execution of our strategy. Antonio and I look forward to continuing our execution momentum through fiscal year 2023 and beyond.

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 pick up your handset before pressing the key. To withdraw your question, please press "*" then "2." We also request that you only ask one question.

Our first question will come from Aaron Rakers with Wells Fargo. You may now go ahead.

Aaron Rakers

Yes. Thanks for taking the question. And congrats on the solid performance. I wanted to ask a question more strategically in thinking about the product portfolio. You guys and many others, obviously talking a lot about ChatGPT, GTP and Generative AI. In the conversation on today's call, you alluded to the fact that you're well positioned with some of your HPC and your high-performance compute platforms, and I want to make sure I understood what you're saying a little bit correct.

Are you participating in some of the infrastructure in some of the cloud opportunities, or how do you see yourself participating in these AI investments that really seem to be driving this narrative around meaningful deployments of accelerated compute? Thank you.

Antonio Neri

Well, thank you, Aaron. Obviously, AI is now front and center in the IT community, because of what we saw in the last couple of months. And as I said, has the potential to disrupt every industry. We cannot talk about what specific cloud, that is what specific cloud they use our specific Cray systems. But I will say, we have a bigger opportunity than that because when I think about the deployment of these large language models that require supercomputing capacity, and at that point, when you think about what we did with Frontier is how we make that accessible to every enterprise of every size.

And so we, as a company, have a unique opportunity that happens every so often where there is a massive inflection point like AI and LLM. The large language model with a unique differentiation in our IP, which is a combination of organic assets that we built over a number of years and the acquisition of Cray. So, as Tarek said in his remarks, we are assessing what is the type of business model we can deploy as a part of our As-a-Service model, by offering, what I call, a cloud supercomputing IS layer with a Platform-as-a-Service that ultimate developers can

develop, train and deploy these large models at scale. So that's why we said early on, we will talk more about that in the subsequent quarters. But we are very well positioned, and we have a very large pipeline of customers. Last week, I was in Europe, and I was amazed to see the large pipeline customers that they are demanding that. And I mentioned one specific customer, Aleph Alpha which is already coming to us to do that.

Jeff Kvaal

Thank you, Anthony...thank you, Aaron. Next question, Anthony, please.

Operator

Our next question will come from Meta Marshall with Morgan Stanley. You may now go ahead.

Meta Marshall

Great. Thanks. You noted, obviously, seeing some weakness in the environment. Just wanted to get a sense of either customer type or vertical or just segment that you've got to see be the source that weakness throughout the year? And are you seeing more people opt for GreenLake subscription offerings as a result of more macro sensitivity? Thanks.

Antonio Neri

Sure. I don't think there is one specific geography or one specific segment. I will say, as we said in the early remarks, the Compute business, obviously, we see a little bit more unevenness, if you will, with longer sales cycles because also they are digesting all what they acquired last year, because of the supply chain and the costs rising. But when you look at the rest of the segments, as Tarek said and I said, the Intelligent Edge business, the Connectivity business, is very, very solid. And we exited once again in Q1 with an extremely elevated book of orders.

HPC, we just talked about it. We see an amazing pipeline in front of us. We have only deployed one exascale system, and we have few to go because we are delivering all of them to the Department of Energy. And then as I said earlier, we have an opportunity to grow that business through an As-a-Service model. But that said, what customers are telling me is that they need a hybrid cloud experience. And we see, in some cases, repatriation of workloads on-prem, but they want the same cloud experience with the same consumption model, and that's what GreenLake does extremely well. It's a true hybrid cloud experience for low-dose overloads, where data, data compliance and cost plays a big role, and that's why we see the momentum we have. The fact that we doubled the total contract value from Q1 2021 to Q1 2023 from \$5 (billion) to \$10 billion, it tells you the momentum.

What I'm really pleased is the fact that two-third of that momentum is in software and services, which means we will be more resilient as we go forward to weather some of these challenges because it's a recurring revenue. And we count in that, just to be clear, through Software-as-a-Service subscription and consumption, which is exactly the way it's supposed to be. And that's why we are very bullish about our GreenLake and the fact that we crossed \$1 billion ARR, it's just a testament that we have a winning strategy.

Jeff Kvaal

Thank you, Meta. Next question, please.

Operator

Our next question will come from Samik Chattejee with JP Morgan. You may now go ahead.

Samik Chattejee

Yes. Hi, thanks for taking the question. Congrats on the execution here. My question was more on the full year guide, and I understand some of the headwinds in certain segments that you're calling out, but the revenue guide goes up by about 300 basis points for the year. The operating profit growth sort of goes up by 100 basis points. And while I understand some of the headwinds, what maybe I can use some help on is really understand the mix implications of how you're thinking about it, just given the more lower sort of flow-through that we're seeing to operating profit growth for the full year guide? Thank you.

Tarek Robbiati

Sure. So thank you for remarking that our revenue guide at the midpoint is effectively doubling from the prior guide that we gave. The prior guide that we gave was 2% to 4%. We're now guiding 5% to 7%. So at the midpoint, it is 6%, which is double what we gave previously.

And in giving that guide, we factor in a number of elements. First of all, the macro environment, second of all foreign exchange rates, and third of all, our desire to continue to invest to perpetrate the momentum that we have in the second half and in fiscal year 2024 because there's always something else that we have to think about for the end of the year, and we're not done yet. I also want to flag that we believe that commodity costs are coming down in particular areas, which should effectively come with added pricing pressure in compute, and this is also something that we have factored into our guidance. But if you really think about our non-GAAP operating profit growth. The prior guide was at 4% to 5% growth, and now we're guiding 5% to 6% growth, and we feel comfortable with the information we have on the macro, foreign exchange rates etcetera, that our guide is appropriate.

Jeff Kvaal

Thank you, Samik. Next question?

Operator

Our next question will come from Kyle McNealy with Jefferies. You may now go ahead.

Kyle McNealy

Great. Thanks for the question. It was a great quarter for Intelligent Edge. Can you help us understand how we should think about a big quarter here in Q1? Is that level sustainable going forward or was there some big deals or particular activity that you would call out that isn't likely to repeat? Your guidance implies it decelerates from here, but can you give us a sense for how we should model this going forward and how frequently you might see growth ahead of your mid-teens growth guidance? Thanks.

Antonio Neri

Yes. Thanks Kyle. No, there was not a unique deal. This is the continuous momentum we have had now for a number of quarters. The book of business in this particular business segment continue to be extremely elevated. As Tarek said, we continue to gain share. And I think it's because we have a unique value proposition, which is a cloud native offer for all aspects of connectivity. We announced now the acquisition of Athonet, which we will integrate the private 5G into the same control plane. And today, we announced the acquisition of Axis Security, which is the secure access secure edge at the top. And so when we think about the book of business, the incredible pipeline we have ahead of us, the execution of the team, the easing of the supply, although in this particular business, there is a little bit more constraint on the supply compared to the other businesses. We talk about a Rule of 40, and this was the

Rule of 50 something, I guess. But the fact of the matter is that, as Tarek said, we expect to grow double-digits. And in the mid-20s on operating profit. This business is now humming and it's going to be one of the most important growth engine as we go in the future.

And as Tarek said, it's also allowing us to be less reliant on the rest of the portfolio, which is very, very critical. And this comes with a high gross margin, obviously.

Tarek Robbiati

I would simply add to what Antonio said, the Edge have broken the \$1 billion revenue bar. I think now we are entering a phase with all the additions that we're making to the portfolio. We're entering a phase of a new watermark level. We have built at the edge with Antonio and the management team, one of the most comprehensive portfolios of the entire industry. And it is really, really winning shares even in the largest customer segments, thanks to the Edge-to-Cloud platform that Aruba has built and that powers GreenLake in everything we do.

Antonio Neri

And I hope the market will take notice of that and give us a little bit of recognition about the work we have done in this particular segment.

Jeff Kvaal

Thank you, Kyle. Next question please.

Operator

Our next question will come from Simon Leopold with Raymond James. You may now go ahead.

Simon Leopold

Thanks for taking the question. I know this is going to be a bit of a tricky one, but I want to see if you could help us understand why your view sounds more optimistic than your other IT-exposed peers, whether it's around, in particular, the Compute side of the business as a storage. I get Intelligent Edge, so I'm not really pushing there. But just the contrast in your outlook on storage and compute versus some of your peers. Can you help us understand that?

Antonio Neri

Sure. Thank you Simon. Well, first of all, let me start by saying, we have a unique strategy and a very diversified portfolio. Some of our competitors don't have the breadth and depth of our portfolio. Some of them are just playing compute and storage, some of them play just in storage, some of them only play in networking. And by the way, let's remind ourselves that one-third of our recurring revenues come from services, which is unique in our space. So we have a unique portfolio, which is incredibly relevant in the mega trends we see in the market. What we have done really well, I will say, Simon, is we brought all that unique portfolio in an integrated solution and experience through HPE GreenLake. And now the HPE GreenLake is a winning strategy for us because it's very hard to do.

One thing is to offer just a subscription model on some sort of solution. But when you leverage a true as-a-Service model across all line of businesses, let me remind you, architecturally, I drove a vision with the team that everything we do, whether you consume it as a service or you consume it in a traditional way, that entire experience is delivered now to HPE GreenLake. Whether you deploy a compute node somewhere, whether in the cloud or premise or at the Edge, you need a subscription to that compute node. Whether it's the storage business. Now, you asked about the storage, this product, HPE Alletra, and Tarek mentioned this, is the fastest

product in the history of the company, has grown triple digits on a consistent basis. And you will see more announcements about this platform going forward, but it was conceived to be a SaaS-led offer. And so that's why it's fueling also the recurrent revenue as we go forward. And I think the combination of that gives the customers a unique experience, instead of buying three different things for people, they can consume it all through one integrated experience. And that's why we are confident.

Now on the compute side, obviously, that compute business go through their own processes and cycles. Because we have CPUs that come on and off at different time of the year or years. But Tarek said, we have three concurrent platforms going on that gives us a lot of flexibility to attack specific customer segments with different configure and pricing. And generation 11 is unique because we address three specific needs, the hybrid cloud need, the security need and the workload optimization. And it comes with unique technologies that actually lift the up because now it's more structural, because we're adding DDR5 memory, which basically means more content into the server. And that's why we believe we can manage through this transition. But if you look at the performance of that business, it was best in class, 90% year-over-year growth and an amazing 17.6% operating profit. And when you look at some of our competitors, as a combined business, not even come to the same number we delivered just on compute.

Jeff Kvaal

Simon, thanks very much. Let's move to the next question, please.

Operator

Our next question will come from Amit Daryanani with Evercore. You may now go ahead.

Amit Daryanani

Thanks for the question and congrats on the quarter. I was wondering if you could just talk about what's the timing for the H3C transaction from here? And then how do you think about the usage of the proceeds that you get from here because, I think, if you sell the stake you have, it would be dilutive by about \$0.17 to \$0.18 of EPS line. So I'm just wondering, how do you think about using the proceeds and offsetting the dilution potentially? Thank you.

Antonio Neri

Yes. So thank you, Amit, for the question on H3C. We exercised the put, as you recall, towards the end of the calendar year of 2022. And we are right now in the process of agreeing the value of our stake with our partners of Unigroup. And this process is going to take a few months and we expect it to complete towards the end of calendar year 2023, and we feel reasonably good about the prospects.

For the meantime, we continue to consolidate H3C and benefit from the dividends that we receive from the company. And we are not deconsolidating H3C at this stage. It's most likely going to be the case of the end of fiscal year 2023 when that will happen. And at that point, we will advise both on the impact of dilution from deconsolidation and also the use of proceeds once we receive them. I would like to also emphasize that we continue to have commercial agreements with H3C, notwithstanding, the exercise of the put, those commercial agreements are distinct from the exercise of the put, and we will continue to generate value through those commercial agreements that we have with H3C.

Tarek Robbiati

Yes. And as always, we're going to apply the same discipline for returning capital to shareholders and continue to invest in the business at the appropriate time. But until we finish

this process, it's just emphasizing. We have to go through the process and complete the agreement.

Jeff Kvaal

Amit, thank you. Next question please.

Operator

Our next question will come from Sidney Ho with Deutsche Bank. You may now go ahead.

Sidney Ho

Great. Thanks for taking my question, and congrats on the strong results. So I also have a question on the full year guide being up 3% to 6%...I think it's 5% to 7%. And, obviously, impressive compared to your peer, which just down-ticked earlier today. But if I look at the midpoint...take a midpoint of your fiscal second quarter guidance, it would assume the second half of the year will be down slightly from the first half, which is unseasonal. It's normal seasonality is up, call it, 5%.

Can you talk about what's embedded in your second half revenue guidance? Is that all driven by your view on the macro side, any one-time item that we should be thinking about in the first half? And maybe how we should think about the backlog helping...delivering from your backlog help offset some of the demand weakness from half-over-half basis at the standpoint? Thanks.

Tarek Robbiati

Okay. A lot of questions into one question, but I will try my best. So first and foremost, the revenue growth that we are targeting for the full year is 5% to 7%, which at the midpoint is 6%, which is double what we originally anticipated. And that is because of all the puts and takes in our portfolio and the way we see supply easing on one side, also demand continuing unevenly although across our portfolio. And if you really look at our EPS guide, one thing I would like to emphasize for everyone on the call is that we did beat the midpoint of our guide by \$0.09 and \$0.03 of that beat pertained to OI&E and had to do with foreign exchange gains that are not operational.

We continue to view OI&E on the full year basis being an expense of \$20 (million) to \$40 million due to elevated interest expenses. And there is also in our guidance, the potential impact from FX volatility. And so, what is baked into our guidance is just that our current view to the best of our knowledge of the macro environment, the impact of interest rates and also the impact of foreign exchange rates that we see at this stage, knowing that things can evolve. It's also important to note that this is our first quarter. We still have nine months to go, and we want to make sure that we remain prudent in the current circumstance where the macro environment remains uncertain.

Jeff Kvaal

Sidney, thanks very much, and we'll take two more questions, Anthony?

Operator

Our next question will come from Wamsi Mohan with Bank of America. You may now go ahead.

Wamsi Mohan

Yes. Thank you. Can you talk a little bit about how much incremental orders in your backlog you were able to satisfy versus what you had anticipated going into the quarter given the fact that some of these supply chain improvements came through the course of the quarter? And

can you also maybe help us think through what you're expecting from an FX headwind now in fiscal 2023 relative to your SAM guide of a \$0.30 headwind to EPS? Thank you.

Antonio Neri

Thanks, Wamsi. I will answer the first part and Tarek, on the second part. Not enough. I mean, the fact of the matter is that we made some progress, but not enough progress against that very strong order book. And that's why we exit Q1 with 2X normal historical levels. Now, we expect that to continue to improve, obviously throughout the years as supply continue to ease. But again, we have a good pipeline in front of us. And so, the goal is to continue to fill the order book.

But when you ask me about how much progress we made in Q1, not enough. If you look at our Intelligent Edge business, it is extremely elevated. Our HPC business, when I look about the future deliveries we have to lever is always very, very strong. Storage is good, and Compute is still there. So we have work to do, more work to do. And then on FX, I think...

Tarek Robbiati

Oh, yes. Thank you, Antonio, and thank you, Wamsi. This gives me the opportunity to remind everybody that at SAM in last October, we flagged at least a \$0.30 headwind from foreign exchange this fiscal year. Quite honestly, the headwind we have experienced in this quarter of 550 basis points is above what we anticipated. We still feel that we can attain our new guide on revenue growth and EPS, notwithstanding the current FX headwinds, but things can always evolve and this is why we remain prudent in our full year guide, with regards to revenue and EPS growth. So that 30-plus percent EPS impact from FX has risen, but we are managing it and factoring it into our new guide.

Antonio Neri

On that point, I think it's simply remarkable because we have to cover all of that \$0.30 started right operationally.

Tarek Robbiati

Yes.

Tarek Robbiati

The fact that, we are raising the midpoint from the \$2, which included a \$0.30 headwind now at \$2.06. It shows you that the mix of the business is going in the right direction, the expansion of the margins and the productivity we continue to drive. Despite the fact the FX actually got worse at the time. And that 550 basis point is pretty significant. So I think from our vantage point, we are doing all the right things and we're confident in that guidance we just provided to you.

Jeff Kvaal

Thanks very much, Wamsi. And Anthony, last question please.

Operator

Our final question will come from Ananda Baruah with Loop Capital. You may now go ahead.

Ananda Baruah

Hey, good afternoon, guys. Really appreciate it. Antonio, I would love to get any context you can provide going back to the AI and large language model conversation. Is there any useful way for us to think about the required resources difference and in what you're seeing for those

applications relative to typical high-performance Compute application resources? And then are you also seeing, for those AI type projects, are you also seeing any impact to the storage attach? And then is there any networking attach impact there as well? Would just love context on those rates? Thanks a lot.

Antonio Neri

Well, thank you. Well, we have been in the AI business now for many years. and we have been in the specific AI upscale business. One of the key differentiations we have in that business, actually several. Number one is what you refer to as networking, I call it interconnect fabric. The ability to connect 40,000 GPUs at scale requires a unique differentiated fabric. That's what the Frontier system is all about.

And as, I think about the next generation of this, we can easily double to 80,000 GPUs because our software and our silicon scales to those levels. And so, that's a unique value proposition that you don't get in the traditional commoditized cloud environment. The other key differentiation we have is the programming environment we acquired to the Cray acquisition because when you develop these AI models, you have to deploy and you have to manage it at scale to take advantage of that massive set of capabilities. That also is a unique software value proposition that's very hard to duplicate.

And then, last but not least, to be able to leverage all these wonderful capabilities, you have to be able to prepare the data. And the data pipeline requires a lot of work upfront because it has to be clean and compliant and all of that. And that's why our acquisitions like Determined AI and Pachyderm in particular, now allows us to automate that data pipeline. But we are not stopping there. We continue to move up and build what I call the platform as a service for developers, so they can take advantage of this automation for the data, train the models and then deploy the model. And if they need a supercomputing type of capabilities, we will be there for them.

So that's why, I said early on, we are in a unique point in time, where an inflection in the market intersects a unique set of capabilities, which we intend to fully capitalize top to bottom, not just on the hardware level, but all the way to the software level. And you will hear more about that as we come to the next months and quarters. And I'm really excited about that opportunity because we already have customers coming to us, we need that, and they are generally enterprise customers that deploy these large use case model that they don't want to spend hundreds of millions of dollars, but they want to use it As-a-Service.

Okay. Well, thank you, everyone. I always appreciate you making the time to talk to us. I know today was an incredible busy day about all the earnings being posted. But let me remind you a couple of things. First of all, today results is not a coincidence. It's a combination of many things we have done over a longer period of time. It is the fact that we have a unique strategy, we have been consistently executing with discipline at all levels, driving cost discipline, productivity, investing organically, and inorganically to bolster our unique portfolio aligned to those trends we discussed today.

We generated a record-setting performance in the first quarter for our shareholders. It was the highest revenue quarter since 2016. We delivered the best non-GAAP operating profit and the highest ever EPS net diluted earnings per share. And I believe we are very well-positioned to navigate this uneven market. As always, there is always more work to do, no question about that. But I think we have a world-class team, a unique culture and customers want us to be there for them through this tradition.

So, thank you very much, and I look forward to see you at the next call or in one of the conference calls we do with you.

CONCLUSION

Operator

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