Hewlett Packard Enterprise

Second Quarter 2021 Earnings Conference Call

Tuesday, June 01, 2021, 5:00 PM Eastern

CORPORATE PARTICIPANTS

Antonio Neri - *Chief Executive Officer*

Tarek Robbiati - *Chief Financial Officer*

Andrew Simanek - *Head of Investor Relations*

PRESENTATION

Operator
Good afternoon, and welcome to the Second Quarter 2021 Hewlett Packard Enterprise Earning Conference Call. My name is Matt, 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, Mr. Andrew Simanek, Vice President of Investor Relations. Please proceed.

Andrew Simanek
Good afternoon. I am Andy Simanek, Head of Investor Relations for Hewlett Packard Enterprise. I would like to welcome you to our fiscal 2021 second 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 a slide presentation accompanying today's earnings release on our HPE investor relations webpage at investors.hpe.com. As always, elements of this presentation are forward-looking and are based on our best view of the world and our businesses as we see them today.

For more detailed information, please see the disclaimers on the earnings materials relating to forward-looking statements that involve risks, uncertainties and assumptions. For a discussion of some of these risks, uncertainties and assumptions, please refer to HPE's filings with the SEC, including its most recent Form 10-K and Form 10-Q. HPE assumes no obligation and does not intend to update any such forward-looking statements.

We also note that the financial information discussed on this call reflects estimates based on information available at this time and could differ materially from the amounts ultimately reported in HPE's quarterly report on Form 10-Q for the fiscal quarter ended April 30, 2021. 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, 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 and 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, and good afternoon, everyone. Thank you for joining us today. While great progress is made in the fight against COVID, it's also clear that it's still a global challenge. I want

to take a moment to acknowledge the suffering occurring in India and elsewhere as communities confront devastating COVID surges. We will continue to do everything we can to support our team members, customers and communities through this very challenging time.

Hewlett Packard Enterprise had a strong second quarter. I'm very pleased with our results and that they are marked by revenue growth, strong profitability and free cash flow. The overall demand environment is improving, and we are seeing traction across our portfolio. We saw solid sequential improvement in total HPE orders growth that was up mid-single-digits with double-digit growth in HPE GreenLake and HPC business segments.

We expect to continue to see improvement in customer IT spending throughout 2021. Our disciplined execution on our strategic priorities aligned at the Security Analyst Meeting last fall is positively impacting both top and bottom line performance. We are strengthening our core businesses, doubling down in key areas of growth and accelerating our as-a-service pivot, while advancing our cloud first innovation agenda to become the edge-to-cloud platform-as-a-service choice for our customers and partners.

We have also executed well throughout the industry-wide tightening and cost inflationary trends with minimal impact to our first half. We have taken proactive inventory buffering measures to position us well for the second half. We will continue to take additional inventory actions as appropriate in alignment to the market demand by leveraging great engineering capabilities and our long term agreements with our suppliers.

Our continued strong performance gave us the confidence to raise our fiscal year '21 EPS and free cash flow outlook for the third time since our Security Analyst Meeting. We will provide more details about this new guidance later in the call.

First, let me review some key Q2 highlights. Revenue of $6.7 billion was up 9% year-over-year with better than normal sequential seasonality. I'm particularly pleased with the double-digit revenue growth in both, our HPC and Intelligent Edge businesses that together now represent 22% of our HPE total revenue. Our as-a-service annual recurring revenue growth was an impressive 30% year-over-year, which underscores our momentum in enabling consumption-base IT. This is an important long term growth driver for our company.

We made significant improvements in both, gross and operating margins. Our non-GAAP gross margin of 34.3% is at record level and up 210 basis points year-over-year. Our non-GAAP operating profit of 10.2% is up 300 basis points year-over-year. And our non-GAAP EPS of $0.46 is up 70% year-over-year and above the high end of our outlook range. These results contributed to Q2 free cash flow of $368 million, which is up $770 million year-over-year, bringing our first half fiscal year '21 free cash flow to a record $931 million.

Tarek will discuss the financial results and outlook in greater detail. Before he does that, I want to provide additional comments on our business segment performance and highlight some of the innovative solutions and experiences we've introduced during the quarter.

HPE has been driving transformation in our businesses to deliver a modern, secure cloud experience everywhere to help our customers with their digital transformations. Our Intelligent Edge business accelerated its momentum with an outstanding quarter across all metrics. Revenue of $799 million grew 17% year-over-year and operating profit expanded 320 basis points year-over-year. This is the third consecutive quarter of year-over-year revenue growth and sixth consecutive quarter of operating profit expansion.

Edge as-a-service offerings were up triple digits year-over-year and now a meaningful contributor to HPE's overall ARR.

Extending to the edge has never been more critical for enterprises. At Aruba Atmosphere, our signature event for Aruba customers and partners, we announced an expansive set of cross-portfolio, edge-to-cloud security integrations for our Aruba Edge Services Platform **(**or ESP**)**, including SD-WAN technology from our recent Silver Peak acquisition.

Today, our Aruba Edge Services Platform already supports well over 100,000 customers, with 150 new customers added everyday connecting over 1 million active devices .Aruba's built-in identity-based network security is unique in the market and provides the ideal foundation for building a zero trust and secure access service edge. Our comprehensive portfolio and AI-powered cloud-driven platforms, like Aruba ESP and Aruba Central, will continue to accelerate WAN and Security deployments, advance cloud and IoT adoption and fast-track digital transformation. Customers like Walgreen's Boots Alliance and Mercado Libre chose Aruba in Q2 for these reasons.

I am tremendously pleased with Aruba's impressive performance. And it is against this successful backdrop that I want to share that Aruba founder Keerti Melkote has made the decision to retire from HPE. We acquired Aruba in 2015, when we saw the edge as the next frontier. Aruba and Keerti has been instrumental in accelerating this business to the $3 billion business it is today. I'm incredibly grateful for his leadership, and I have personally benefited from his counsel, knowledge and friendship. Keerti will remain as an advisor to me for the remainder of 2021.

I am pleased to announce that effective today, Phil Mottram will take over the leadership of our Aruba Intelligent Edge business. Phil is a results driven leader with extensive experience implementing growth, strategies and leading transformation initiatives. He joined HPE in 2019, and most recently assumed the role as a General Manager of our Communication Technology Group, leading a team of more than 5,000 team members who drive $500 million in CTG specific revenue and $3.5 billion in total revenue for HPE. I'm excited to welcome Phil into this new role and believe he is a perfect fit to ensure we maintain our leadership position and strong momentum in the market.

In our High Performance Compute & Mission Critical Systems business, revenue of $685 million was up 11% year-over-year. We are the undisputed market leader with an industry leading portfolio in AI and deep learning solutions for the new age of insight. We continue to execute on over $2 billion in awarded contracts. And we are pursuing a robust pipeline of another $5 billion in market opportunity over the next three years.

In Q2, we announced several new HPC system deals and collaborations. This include building new supercomputer to advance scientific research for the Swiss National Supercomputing Center, the United States Department of Energy, Los Alamos National Laboratory and the National Supercomputing Center in Singapore. As we have noted on the previous calls, this is an inherently lumpy business due to the lead times, between order and revenue recognition, but we remain on track to deliver our target of 8% to 12% annual growth in this business this year.

Our compute and storage businesses performed very well in the quarter. Our strategy to grow in profitable segments of the market and pivot to more as-a-service solutions is paying off. In compute, revenue of $3 billion was up 10% year-over-year. We drew strong operational performance, expanded operating margins by 550 basis points. We expanded our portfolio with the latest AMD EPYC and Intel Xeon Scalable Processors, which included launching three new HPE ProLiant Solutions, targeting 5G deployments in telco, virtual desktop infrastructure and storage -optimized solutions for database workloads in enterprise.

In storage, revenue of $1.1 billion was up 3% year-over-year with a strong operating profit of 16.8%, up 110 basis points year-over-year. We continue to see strength in key software defined solutions, which drive our ability to attach rich services to our product offerings. HPE Primera and Nimble dHCI both grew triple-digits. Our HPE's all-flash array portfolio grew 20%.

On May 4th, we introduced a new portfolio of cloud native data infrastructure called HPE Alletra. This portfolio delivers workload optimized systems and provides customers with architectural flexibility to run any application without compromise, from edge-to-cloud with our cloud operational experience. These innovations are propelling our storage business into our cloud-native software-defined data services business.

Our pivot to as-a-service continued it is strong momentum. Our annualized revenue run rate of $678 million was up 30% year-over-year. We saw strong total as-a-service order growth of 41%. Over 900 go-to-market partners are now actively selling HPE GreenLake as a part of their own marketplace. And we average a 95% renewal rate, with billings from those customers at 124% usage of the original contract commitment. We have an unmatched portfolio of hybrid cloud services that spans all aspects of networking, compute, storage, VMs, containers, MLOps, HPC and more.

On the innovation front we announced a transformative new data storage services platform that brings our cloud operations model to wherever data lives by unifying data operations. The platform will be available through HPE GreenLake Central and includes a new data services cloud console and a suite of software subscription services that simplifies and automates global infrastructure at scale.

Our industry leading HPE GreenLake cloud services experience enabled us to gain more than 90 new customers during the quarter. Carestream is a great recent customer example. In a three year, multimillion-dollar deal, Carestream selected HPE GreenLake cloud services with HPE Ezmeral software and HPE Pointnext Services to power a transformative new healthcare initiative based on artificial intelligence-as-a-service.

We will continue to invest aggressively in HPE GreenLake cloud services to provide a true cloud experience and operating model, whether at the edge, on-premises across multiple clouds. HPE's businesses that provide services and capabilities to help customers digitally transform also performed well in Q2.

HPE Pointnext Operational Services had another solid quarter with revenue growing year-over-year as reported. We expect to see growth for the full fiscal year, driven by our growing services intensity and other service momentum. HPE Financial Services continued to play an important role helping our customers as they rebuild and rethink their IT transformation requirements. Cash collections continued to improve, and HPE FS delivered a return on equity of 18.3%, well above pre-pandemic levels. This business continued to perform very well.

Over the past year, our global communities have faced a catastrophic health crisis and significant business disruption. At HPE, we accelerated our strategy to be the edge-to-cloud platform-as-a-service company to support our customers' rapidly changing needs. Throughout this time, our 60,000 team members demonstrated amazing agility and perseverance. And I'm tremendously proud of our team members' response during this unprecedented time. I want to thank them for their commitment and passion that has made HPE stronger and better positioned in a world that is forever changed. As businesses emerge from the pandemic and move beyond the age of COVID, digital transformation is at the forefront of their strategic initiatives.

At our Discover Event on June 22nd, you will hear more about how HPE is at the center of this supercharged digital economy. Our edge-to-cloud architecture, software and solutions all delivered as-a-service will continue to help our customers transform their businesses, optimize their applications and data across an increasingly distributed world, and be future ready, today. I'm excited about our momentum, and I believe HPE represents a strong investment opportunity for our shareholders.

With that, let me turn it over to Tarek to review the quarter's results.

Tarek Robbiati
Thank you very much, Antonio. I'll start with a summary of our financial results for the second quarter of fiscal year '21. As usual, I'll be referencing the slides from our earnings presentation to guide you through our performance in the quarter. Antonio discussed the key highlights for this quarter on slide one, and now, let me discuss our financial performance, starting with slide two.

I am very pleased to report that our Q2 results reflect continued momentum in revenue, strong gross and operating margin expansion, and robust cash flow generation. We delivered Q2 revenues of $6.7 billion, up 9% from the prior year period, a level better than our normal sequential seasonality.

I am particularly proud of the fact that our non-GAAP gross margin is at the record level of 34.3%, up 210 basis points from the prior year period and up 60 basis points sequentially. This was driven by strong pricing discipline, cost takeouts and an ongoing favorable mix shift towards higher margin software-rich offerings.

Our non-GAAP operating expenses increased in the quarter, as we previously indicated, due to the planned hiring increases along with R&D and go-to-market investments. This offset by our continued progress delivering on the savings from our cost optimization plan, which is on track. Even with our investments, our non-GAAP operating margin was 10.2%. That is up 300 basis points from the prior year, which translates to a 59% year-over-year increase in operating profit.

Within other income and expense, we benefited from one-time gains related to increased valuations in our Cohesity and IonQ investments within our Pathfinder venture portfolio. As a result, we now expect other income and expense for the full year in fiscal year '21 to be an expense of approximately $50 million.

With strong execution across the business, we ended the quarter with non-GAAP EPS of $0.46, up 70% from the prior year and meaningfully above the higher end of our outlook range for Q2. Q2 cash flow from operations was $822 million and free cash flow was $368 million, up $770 million from the prior year, driven by better profitability and strong operational discipline, as well as, working capital benefits. This puts us at a record level of free cash flow for the first half at $931 million. Finally, we paid $156 million of dividends in the quarter and are declaring a Q3 dividend today of $0.12 per share, payable in July.

Now, let's turn to our segment highlights on slide three. In Intelligent Edge, we accelerated our momentum with rich software capabilities to meet robust customer demand, delivering 17% year-over-year revenue growth across the portfolio. Switching was up 17% year-over-year, and wireless LAN was up 16%.

Additionally, the Edge as-a-Service offerings were up triple-digits year-over-year and now represent a meaningful contribution to HPE's overall ARR. We also continued to see strong operating margins at 15.5% in Q2, up 320 basis points year-over-year, which is the sixth consecutive quarter of year-over-year operating margin expansion.

Silver Peak continues to perform well, leveraging the high-growth SD-WAN market opportunity and contributed about 5 points to the Intelligent Edge top line growth.

In HPC-MCS, revenue grew 11% year-over-year as we continue to achieve more customer acceptance milestones and deliver on our more than $2 billion of awarded contracts. We remain on track to deliver on our full year and three year revenue growth CAGR target of 8% to 12%.

In compute, revenue grew 10% year-over-year and was down just 1% sequentially, reflecting much stronger than normal sequential seasonality. Operating margins were up meaningfully year-over-year due to disciplined pricing and the right-sizing of the cost structure in this segment. We ended the quarter with an operating profit margin of 11.3%, up 550 basis points from the prior year period and towards the upper range of our long term margin guidance for these segments provided at SAM.

Within storage, revenue grew 3% year-over-year, driven by strong growth in software defined offerings. Nimble grew 17% with ongoing strong dHCI momentum growing triple-digits. All-flash arrays grew 20% year-over-year, led by Primera that was up triple-digits and is expected to surpass 3PAR sales next quarter. The mix shift towards our more software rich platforms and operational execution helped drive storage operating profit margin to 16.8%, up 110 basis points year-over-year.

With respect to Pointnext operational services, including Nimble services, revenue grew for the second consecutive quarter year-over-year as reported with further growth expected for the full year of fiscal year '21. This has been driven by the increased focus of our BU segments on selling product and service bundles, improved service intensity and our growing as-a-service business, which I'll remind you, involves service attach rates of 100%. This is very, very important to note, because all of our OS revenue is recurring with three year average contract length, and OS is the highest operating margin contributor to our segments.

Within HPE Financial Services, revenue was down 3% year-over-year as the pandemic did not materially impact this business until later in 2020. As expected, we are seeing continued sequential improvements in our bad debt loss ratios ending this quarter at just 75 basis points, which continues to be best-in-class within the industry. We have also seen improved cash collections well above pre-COVID levels. Our operating margin in this segment was 10.8%, up 160 basis points from the prior year and our return on equity at 18.3% is well above pre-pandemic levels and the 15%+ target that we set at SAM.

Slide four, highlights key metrics of our growing as-a-service business. Similar to the past couple of quarters, we are making great strides in our as-a-service offering with over 90 new enterprise GreenLake customers added, that is in Q2, bringing the total to well over 1,000.

I am pleased to report that our Q2 '21 ARR was $678 million, which was up 30% year-over-year, as reported. Total as-a-service orders were up 41% year-over-year driven by strong performance in North America and Central Europe. Our Edge-as-a-Service offerings also continued to grow revenue strong triple-digits year-over-year. Based on strong customer demand and recent wins I am very happy with how this business is executing and progressing towards achieving our ARR growth targets of 30% to 40%, a CAGR from FY '20 to FY '23.

Slide five highlights our revenue and EPS performance to-date where you can clearly see the strong rebound and momentum from our Q2 '20 trough. For the past two quarters, revenue has exceeded our normal sequential seasonality, reflecting the improving demand environment. And with the operational execution of our cost optimization and resource allocation program, we have increased non-GAAP EPS in Q2 by 70% year-over-year.

Turning to slide six, we delivered a record non-GAAP gross margin rate in Q2 of 34.3% of revenues, which was up 60 basis points sequentially and up 210 basis points from the prior year. This was driven by strong pricing discipline, operational services margin expansion from cost-take out and automation, and a positive mix shift towards high margin software rich businesses, like the Intelligent Edge and next generation storage offerings. We have also benefited from the new segmentation we implemented beginning of fiscal year '20 that has given us much better visibility into each business unit and enabled better operational discipline.

Moving to slide seven, you can also see we have expanded non-GAAP operating profit margin substantially from pandemic lows to 10.2%, which is up 300 basis points from the prior year period. We have done this by driving further productivity benefits and delivering the expected savings from our cost optimization plan while simultaneously increasing our investment levels in R&D and field selling costs, which are critical to fuel our long term innovation engine and revenue growth targets. Q2 operating expenses also included planned increased hiring and spending on select investment to drive further growth.

Turning to slide eight, we generated record first half levels of cash flow with $1.8 billion of cash flow from operations and $931 million of free cash flow, which is up $1.5 billion year-over-year. This was primarily driven by the increased profitability, strong operational discipline and some in year timing related benefits. I would like to underscore that this year, our free cash flow profile seasonality will be different as a result of our backend-loaded restructuring costs and investment in inventory for our supply chain to cater for rising demand and chip shortages as the economic recovery accelerates.

Now, moving on to slide nine; let me remind everyone about the strength of our diversified balance sheet. As of April 30th quarter-end, we have improved the operating company to a net cash neutral position with our strong free cash flow. Furthermore, we have made good progress securitizing some financial services related debt through the ABS market and expect to have close to all of the U.S. portfolio securitized by year-end.

The refinancing of higher cost unsecured debt with ABS financing allows us to boost access to financing markets at a cheaper cost of debt capital, as well as, diversifying and segregating our balance sheet between our operating company and our financial services business. Bottom line, our improved free cash flow outlook and cash position ensures we have ample liquidity available to run our operations, continue to invest in our business, drive growth and execute on our strategy.

Now, turning to our outlook on slide 10, I am very pleased to announce that we are once again raising our full year guidance to reflect the continued momentum in the demand environment and our strong operational performance to-date. This will be our third guidance increase in SAM in October 2020.

We now expect to grow non-GAAP operating profit by 25% to 35% and deliver fiscal year ‘21 non-GAAP diluted net earnings per share between $1.82 and $1.94. This is a $0.09 per share improvement at the midpoint of our prior EPS guidance of $1.70 to $1.88 and a $0.22 per share improvement at the midpoint since SAM.

With respect to supply chain, we have executed well to-date with minimal impacts, and continue to take proactive inventory measures where possible. We do see further industry wide tightening and inflation persisting in the near term, which has been factored in our outlook from both revenue and cost perspective, but overall demand remains strong.

From a top line perspective, we are pleased with the momentum we saw in the first half. And while we continue to see further demand improvement, we remain prudent as certain geographies continue to navigate the pandemic, and we continue to observe uncertainties in the supply of commodity.

More specifically for Q3 ‘21, we expect revenue to be in line with our normal sequential seasonality of up low single-digits from Q2. For Q3 ‘21, we expect GAAP diluted net EPS of $0.04 to $0.10 and non-GAAP diluted net EPS of $0.38 to $0.44. Additionally, given our record levels of cash flow in the first half and raised earnings outlook, I am very pleased to announce that we are also raising FY '21 free cash flow guidance to $1.2 billion to $1.5 billion, that is a $350 million increase at the midpoint from our original SAM guidance.

So overall, Antonio and I are very proud of the progress we have made in the first half. We have navigated well through the pandemic and are exiting the first half with improved revenue momentum, strong profitability, and robust cash flow.

Our growth businesses in the Intelligent Edge and HPC & MCS have accelerated top line performance, our core business of compute and storage revenues are growing with improved margins, and our as-a-service ARR is accelerating. We also continue to execute well against our cost optimization and resource allocation program, which has made us leaner, better resourced and positioned to capitalize on the economic recovery currently at play.

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 keys, to withdraw your questions, please press "*" then "2." We also request that you only ask one question.

The first question comes from Wamsi Mohan with Bank of America. Please go ahead.

Wamsi Mohan
Yes. Thank you. And congrats on another beat and full year free cash flow rise. I was wondering if you can dig a little bit more into the guidance dynamics, you know, you’re guiding 3Q a little bit below The Street, 4Q slightly higher. Can you maybe address what the visibility you have into 4Q is? And how much of supply chain impact are you baking in into 3Q, 4Q? Is that both the demand and the cost level? Thank you.

Tarek Robbiati
Yes. Wamsi, hi. It's Tarek here. So let me try and dissect the guidance we gave for Q3 and also the full year. So putting things in perspective; first, we are raising our FY '21 EPS outlook by $0.09 at the midpoint to $1.82 to $1.94 based on our Q2 outperformance. And we feel very confident for the rest of the year. This reflects what we see as continued improvement in customer spending, but also we want to remain prudent given the remaining pandemic and supply chain uncertainty. Specifically for Q3, it's important to note that we do expect revenue growth in line with normal FY '18, FY '19 sequential seasonality of up low single-digits. We anchored you on FY '18, FY '19 and not last year because of the disruption we suffered in the supply chain last year. So it's better to look at it from an FY '18, FY '19 viewpoint.

You should expect that gross margins hold roughly flat relative to our H1 levels, near just under 34%. OPEX should be up somewhat as we continue to make select investments aligned to our strategy in key growth areas, and this is partially offset by further efficiencies we find. But most importantly, it is important that you note that OI&E will flip to an expense overall in the full year, and therefore, in the second half. OI&E in Q1 was a positive income and Q2 was a positive income. And now, we're expecting for the full year '21 a $50 million expense, hence, the guidance that we're giving you overall for Q3. You can expect that the tax rate will be unchanged at 14%, like we said at SAM. And the net of all of this is that we expect our Q3 non-GAAP EPS to be in the range of $0.38 to $0.44, and we feel pretty comfortable with it.

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

Operator
Our next question will come from Matt Sheerin with Stifel. Please go ahead.

Matt Sheerin
Yes. And thank you. I just wanted to ask your take on the forward guidance, which implies low single-digit sequential growth following above seasonal quarter in April quarter it sounds like backlog continues to be strong. So are there particular pockets of areas where you're seeing a slowdown or maybe more cautious outlook for...from customers because they're still dealing with the pandemic issues?

Antonio Neri
Maybe I'll start; I know Tarek has many comments. I mean, we see strong demand momentum right now. We quoted in our remarks that we're up mid-single digits. And therefore, we translate that conversion into revenue. But obviously, part of the improvement could come from the HPC acceptances. Remember that on HPC, our order to revenue is a little bit more lumpy, because of the time between orders and revenue takes longer. But overall, what we are confident is the fact that we see obviously IT demand improving. But I'm really pleased with our innovation and our ability to execute against that innovation. The innovation we have across the portfolio is perfectly timed what we see in today's environment. We live in a much more distributed enterprise, obviously, digital transformation is essential to operate in this digital economy and the first step is connectivity. And I have to tell you, the Intelligent Edge business is absolutely incredibly strong. You saw in actual dollars, almost 20%. And we expect to continue to be super strong for the balance of the year into 2022, honestly. And that's because we have a business of scale. We have a massive business scale, and to give a point of reference, we already have 100,000 customers on that platform. We add 150 customers every day. We manage more than 1.1 million devices. And honestly, we actually manage data of 1 billion plus per hour, data points that comes

through our cloud. And so, we expect that to continue to be very strong. I think, the core business has definitely stabilized. And we see pockets of improvement, particularly with storage. And then, the as-a-Service will continue to stay strong. Again, we are cautious about the supply chain aspect of this. But, we position ourselves well for the second half, and that was all factored in our guidance, absolutely well factored in our guidance. So it's why we raised the guidance.

Andrew Simanek
Perfect. Thanks, Matt for the question. Can we have the next one, please?

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

Katy Huberty
Thank you. Good afternoon. My congrats on the quarter as well. I want to come back, Tarek, to just reconciling the improving growth trajectory in all of your segments with the second half EPS guidance that assumes well below normal seasonality or about 40% of EPS coming in the back half versus past years. You typically have low to mid 50% second half EPS mix. I think, I heard you mention supply chain constraints and being cautious around that and COVID and general cost inflation, investments you're making and then the OI&E dynamics. Can you just rank those...well, first, did I forget any? And then, can you just rank those factors in terms of which are having the most impact on your back half EPS guidance? Thank you.

Tarek Robbiati
Yes. Thank you, Katy. So let me try and add a little bit more color to what we said already. So first of all, remember, our cost optimization and allocation program. We exited FY '20 very lean and this has driven a very strong performance in Q1 at $0.52 per share. This is a level of earnings that was actually benefiting from the fact that we have a very strong run rate entering into Q1. In Q2, you saw that momentum continuing with the EPS that we posted at $0.46 per share. Very comfortable with the level of investments that we are making, and this is also showing in the gross and operating margin expansion that we've demonstrated so far.

So, now, when you also look at how this translates into free cash flow, obviously, we had a lot of free cash flow benefits into Q1, Q2 as a result of this earnings strength and which translated into free cash flow. But moving forward, what you have to factor into the guidance on earnings is the fact that there is some degree of uncertainty on supply chain. Although, as Antonio said, the demand is very strong across the board. The demand is very strong in Aruba. The demand is very strong in Compute. And you can see that with units going up year-over-year. And also in HPC-MCS, we are seeing the revenue trending in the range that we guided at SAM. This is all good.

Having said that, we have also to reckon two other dynamics, aside from the cost optimization program and the demand, the other dynamic is OI&E, which affects EPS in Q3 and Q4. In Q1, Q2, we had two income quarters as far as OI&E is concerned. They'll flip into an expense of $50 million for the full year, gives you an order of magnitude of what would be the EPS for each one of Q3, Q4.

And then, on free cash flow, the other final element that drives it is, we have to deal with supply chain and we continue to buffer inventory to be ready for the demand in fiscal year '21 for the second half, but also fiscal year '22. We do not expect that the situation on inventory is going to be all of a sudden setting up across the world and across the industries, and we've taken steps, and we'll continue to do so. So overall, we're managing, I would say, the resurgent demand environment very well. We're lean from an organization standpoint. Our earnings power is shown by the margins we're posting. And also, you could see that what we're doing on free cash flow, we're doing very, very well.

So hopefully, that gives you a color to your questions with the rankings of the various effects at play.

Antonio Neri
Katy, this is Antonio. I just want to reinforce a couple of things. I understand the normal sequential seasonality, people trying to get into it. But the fact of the matter is we are delivering record-breaking gross margin. We are raising our EPS guidance despite the supply chain uncertainty. And our business is in huge demand, and it's not just the IT demand, it's the fact that we have unique portfolio, edge-to-cloud, that's meeting the customer needs of today and future ready for tomorrow. And so, I think the fact is that when you look at the full year, right, we have raised guidance now three times. And to Tarek's point, it's more than 25% from the beginning of the year. And that's a testament of the momentum we have in the business. Then obviously, every quarter has ups and downs because of unique things like OI&E or maybe more inventory build-out. But in the end, the takeaway is that we are raising again the EPS for the full year and free cash flow.

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

Operator
Our next question will come from Kyle McNealy with Jefferies. Please go ahead.

Kyle McNealy
Hi, thanks very much for the question. I wanted to see if you could give us a sense for the position of your compute installed base. We saw F5 had stronger than expected upgrade activity to hardware systems coming out of the worst days of COVID impact. For you guys, how high is the average age of your compute installed base versus normal levels? And are you seeing any upgrade activity start to come through now for on-premise hardware after COVID-related delays last year?

Antonio Neri
Well, sure. Obviously, we are one of the market leaders today in terms of whatever you look at, revenue, market share. But obviously, our portfolio, ProLiant, is on 23 years in the making and our installed base is incredibly large. The average is probably between four, five years, Kyle, at this point in time. Definitely, it's a pent-up demand to modernize that infrastructure. But, it's not just replacing hardware for the sake of replacing hardware. It's to really bring the cloud experience to our computer source and more and more be able to consume it elastically as-a-service. And that's the unique value proposition we have, which is not only just the best infrastructure with ProLiant as a franchise, but the fact that we have a provisional life cycle management and you should stay tuned for more announcements here shortly, but also be able to pivot that installed base to more a consumption base over time, and then more and more as a well to optimize solutions. And remember, these platforms come also in a different structure in the sense that you have more options and more technologies built into the platform. And so, for us, it's a big opportunity. And I think an accelerator of that transition is our GreenLake business. It's not just replacing the old infrastructure or the CAPEX, but being able to bring and repatriate workloads on-prem, where it makes sense, or actually hold workloads on-prem, because now we can deliver a true cloud experience in our consumption-driven model.

Tarek Robbiati
And let me add to this, Kyle. There's also another aspect that we see the pent-up demand and really the need to modernize the infrastructure and the way the infrastructure is used. But also, if the decision to actually modernize the infrastructure and moving to consumption isn't made, it's not bad for us, because we benefit from extended leasing with our financial services portfolio, which has been doing extremely well with our asset management business as people tend to use the infrastructure more, absent a decision or an availability of supply for the equipment they want to use. So, it's good for us on all fronts. And we're very happy with that performance on both, the core compute business and HPFS.

Antonio Neri
And last but not least, let's not forget just the hardware is the Operational Services that come with it, because every upgrade cycle, whether it's the traditional way or as-a-Service, obviously, as-a-Service is even better, because it comes with 100% attach of Pointnext OS. We have seen richer configurations and higher services attached. And that's why part of the gross margin expansion you saw in Q2, in compute which was 550 basis points, comes also after the fact we are attaching more services to our infrastructure.

Andrew Simanek
Great. Thanks for the question Kyle. Can we go to the next one, please?

Operator
Our next question will come from Aaron Rakers with Wells Fargo. Please go ahead.

Aaron Rakers
Yes. Thanks for taking the question. And congratulations on the quarter and the raised guide. One of the things that comes up obviously is your asset, H3C. I'm just curious any updated thoughts on how you are thinking about that put optionality, which I believe expires in early '22. And how are you thinking about kind of the use of capital, any kind of thoughts on more flexibility on M&A or any strategic thoughts on that front? Thank you.

Antonio Neri
Well, I'll start and then Tarek will comment. Listen, we still have roughly a year to make the decision that would expire in May 2022. Let me remind everybody that obviously China is the second largest IT market and growing. And our setup is unique…is unique in many ways to fulfill the needs of a unique market like China. And I think that joint venture with the partner has been incredibly successful driving shareholder value through H3C level and also through us, right, because obviously we collect dividends from that joint venture. But it's a way to reach a market that's very hard to compete in. So we will continue to relay what is the best use of that capital in the context of participating in China, and if we decide to take action what to do with our capital. But right now, we have not decided one way or the other one. We continue to explore what is the best return for shareholders and also to position the company for growth as we think about the future.

I don't know, Tarek, if you have any comments?

Tarek Robbiati
You said very well, Antonio. We have time to make the decision. The put expires in April 2022. So we have a little bit less than a year, and that is to sell all or part of our 49% stake in units. We feel that this is a stake that continues to accrete value. Just to put things in perspective for

everyone on the call, in fiscal year ‘20 alone, the equity interest contribution from H3C grew over 20% to $212 million for fiscal year ‘20. We expect that growth to continue, and therefore, the value of our stake to continue to accrete.

Andrew Simanek
Great. Thanks for the question Aaron. Can we go to the next one, please?

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

Shannon Cross
Thank you very much. I was just going to ask about acquisitions in general and your M&A thoughts. It’s been about a year since Silver Peak, a couple of years since MapR. Just I know you’ve made some small acquisitions in the interim. But I’m wondering with the liquidity position you have, the cash flow and your approach to growth where you’re at and what you might think are some holes in your portfolio? Thank you.

Antonio Neri
Yes. No, thank you. Obviously, M&A is an important component of our strategy. And as we have done, at least I have done now, probably 19 of them have always has been about, obviously, very stringent return on invested capital, very disciplined in that approach. But it’s always about bringing intellectual property and talent to accelerate our edge-to-cloud platform vision. Silver Peak was completed in September last year, and now fully integrated into our business and now we start seeing the momentum in our Intelligent Edge business, and all the ones we are doing along the way, particularly around data and software defined assets and so forth. So, again, we continue to evaluate what is available there, notwithstanding the fact that we have to be incredibly disciplined. As you know, valuation seems to be a little bit too high for some of the assets. But again, if there is something out there that makes sense, we will evaluate it, and we will take the right action. But again, it’s an important component of our strategy going forward. And I always talk about you know, the Aruba like type of things, but we evaluate everything, whatever is relevant for our strategy.

I don’t know, Tarek, if you have any comments on that?

Tarek Robbiati
Yes. Shannon, I mean, it’s very important to maintain discipline and focus in the content…in a context where valuations in some cases, particularly for some class of assets, are a little bit exuberant. But, if we can find two to three Silver Peak type of acquisitions, I don’t think Antonio and I will hesitate a second to just go and press the button.

Andrew Simanek
Great. Thanks Shannon for the question. Next one, please?

Operator
Our next question will come from Amit Daryanani with Evercore. Please go ahead.

Amit Daryanani
Good afternoon. And thanks for taking my question. I guess, I was hoping if you could talk more about the Intelligent Edge performance. The 17% growth, I think is more impressive better than what most of your peers have had on the networking side, other than Arista maybe. So maybe you can just talk about what is driving the inflection of growth over here, and what is the durability

of the double-digit growth really as we go into the back half and beyond? That would be really helpful. And then, if I could ask you to clarify this, because I may have missed it completely. Why is OI&E flipping from positive in the first half to negative in such a big way in the back half?

Antonio Neri
Sure. I will start, and Tarek will talk about the OI&E. I mean, obviously if you look about the way we operate and the growth in IoT and the need for connectivity, obviously, is continuing to grow. Interesting enough, three years ago, I said that the enterprise of the future will be edge-centric, cloud-enabled and data-driven. And it's playing exactly that way. Unfortunately, through the COVID pandemic we saw that acceleration. But, when you think about digital transformation, right, obviously, we live in a digital economy. And the first step is to be connected. If you're not connected, you're not participating. That connectivity is not just many more users and devices and things…everything is connected to the network, everything computes, everything generates data. And so, connectivity is at the forefront of the digital transformation.

And obviously, remote working is requiring the need for WiFi connectivity to a level we haven't seen before. But, that's an example of what's happening out there. But, I will say, our innovation with a true cloud-native platform at massive scale. And again, the fact that we already have 100,000 customers, and we're adding 150 customers every day, that tells you the value proposition resonated. We can provision a WAN port, a LAN port or a WiFi port or a BLE or Zigbee, whatever is the protocol from the cloud. And we're able to do that in an intelligent and autonomous way, because ultimately it's about the data you collect and what experiences you can provide. And so, we believe this is absolutely durable. We are very bullish about this business. We expect this business to continue to grow double-digits for the balance of the year. And as we add more functionality by cloud platform, particularly with edge computing and 5G, we are going to accelerate that momentum. And when you talk to customers and partners, they love the Aruba experience, absolutely they love the simplicity, they love the fact that you improve their experience for their own business, and then powers this new way to work. So that's why we are pretty excited.

And the other thing is that, the platform that Aruba runs the cloud is now the platform we run the rest of the company. When we deploy now one of the data services through the new announcements we made on May 4th, or where we deploy compute or we deploy a workload optimized, is running on the same backend that Aruba was originally created. And that's why we have a true edge-to-cloud platform. And then, we lay on top of that the as-a-Service model, whether its subscription and software, which is growing triple-digit in Aruba, or whether it's the as-a-Service model with GreenLake. And that's the unique differentiation we have in the marketplace. And that's why we feel very good about the growth prospect of this business.

Tarek, on the OI&E?

Tarek Robbiati
Yes. Thank you, Antonio. On the OI&E front, thanks for asking the question as to why we expect OI&E to flip to an expense in the second half. In OI&E, you have effectively three effects. The first one is the H3C economic contribution and the timing of which shifts between quarters, while we…like we said before, we're very happy with H3C and the economic interest that we have through them and the cash they return to us on a regular basis. So it's a timing element there for H3C. There is also interest expense that is the second force in the OI&E line. And then, the third force is the Pathfinder portfolio, our venture portfolio, which has been doing extremely well in the first half, and we did flag this in my script. We said we had benefits from revaluations of our investments in Cohesity and IonQ. We had, in the first quarter in OI&E $16 million income, and

in the second quarter a $27 million income. This is on an aggregate basis across the three forces. So, for the first half, $43 million of OI&E income, and we're guiding for the full year for an expense of $50 million. So that's a $90 million swing, and that $90 million swing, if you turn it into a EPS number, divide that you do the math yourself, it's about $0.07 to $0.08 of EPS for the full year, right. That's the thing you have to reckon when you compute your Q3 or Q4 EPS forecast. That's the swing factor there. It does not change the fact that our operating performance remains very, very solid. The swing factor at the OI&E level is explaining a little bit more hopefully the guidance for all of you on the call.

Antonio Neri
And I will say again, despite all of that, we have raised the guidance.

Andrew Simanek
Great. Thanks for the question Amit. I think we have time for one last question, please?

Operator
Yes. Our final question will come from Sidney Ho with Deutsche Bank. Please go ahead.

Sidney Ho
Thanks for taking my questions, and congrats on solid results and cash flow. My question is on the HPC business. I had expected that business to grow sequentially, especially after a slowdown in Q1. Maybe it's just normal seasonality, but understand the businesses could be lumpy. Are there any trends that you can draw from the last two quarters? Whether deals are taking longer to close or being accepted by customers? And more broadly, what gives you confidence that you can hit your 8% to 12% growth target? Maybe you can talk about what's normal seasonality for that business in fiscal Q3 and fiscal Q4? Thanks.

Antonio Neri
Let me start. I'm going to talk more for the market. Tarek can talk more on the financial side. Listen, the bookings momentum is incredibly strong in this business. So you have to look at the booking side and then you have to look at the revenue side. The bookings continue to be just amazing. And I quote that some of the deals we won. These are multimillion dollar deals.

Seasonality in this business doesn't really play out that well because the fact of the matter is that you have these large systems that need to be built, shipped, installed, you have to run the workload. And then, only then when the customer accepts the system with the workload running, you can recognize revenue. And that time can vary, you know, it can be as quick as three months, as long as a year in some cases, especially when you deploy these massive Exascale systems, which we're going to do starting end of the year and then next year in 2022. And sometimes you need to run the workload for a month, but reinstalling the system from the factory on the floor, sometimes can take up to 60 days. It's just…it's a size of football field.

So, I would not think about the seasonality, I think about the long term growth of the business, we feel pretty good and confident about that CAGR. But, even this year, we believe we're going to deliver the 8% to 12% growth just this year in 2021, right? So this is about keeping the orders book momentum, short term, the life cycle of the supply chain and install and acceptance as much as we can. And then, this business is a lot of softer, right that gets built around the system itself. So that's why we're very bullish about this system…this business. And remember, it's all on the back of the day. That's why we talk about AI and deep learning technologies, data continue to grow exponentially, and you need more compute. That's a fact at the level you haven't seen before.

Tarek, maybe you want to comment on the...

Tarek Robbiati
Yes. I mean, I think you said it very well, Antonio. We simply say, look, the order momentum remains very, very strong. It was up double-digits in Q2. We have a large awarded order book with over $2 billion of contracts. The pipeline that we are having in mind includes another $5 billion of exascale opportunity to be awarded over the next three years. The win rates that we observe are very high. We won five out of six contracts in the Exascale space. It's an inherently lumpy business. So I think if you look at it on a quarterly basis, probably not the best picture. You have to look at it on a multiyear basis. And we feel very confident that we can achieve the 8% to 12% CAGR per year, including starting this year fiscal year '21. And because of the lumpiness of the revenue, you also have lumpiness in profitability as a result of the revenue profile and the product mix that doesn't worry us at all. It's the nature of the beast, so to speak. We feel that HPC-MCS is extremely well positioned as a business segment, to continue to be a very strong tractor of growth for HPE overall.

Antonio Neri
And that growth will continue, which, as I said earlier, right, today, the HPC and the Edge already represents 22% of the company's revenue. And as we go forward with both businesses growing double-digits, that 22% will be bigger at the different margin than the core, right?

CONCLUSION

Antonio Neri
So, anyway I know we are running out of time. Just to close, I'm very pleased with HPE's Q2 results that again, they are marked by strong revenue momentum, profitability and free cash flow. The overall demand is improving, but our execution, our innovation is perfectly timed to the customer needs that we see in the marketplace. And despite there is supply chain uncertainty around specific commodities, we factor all that in, in our ability to execute to the back half, and that's why we are raising once again for the third time in the year, our EPS and free cash flow. And I believe the future is edge-to-cloud, and it's going to be consumption based. Well, I think HP has unique value proposition and set of offerings. And that's why I believe this is a very exciting time for HPE. We have worked really hard, despite the pandemic. Our team has been incredibly resilience. And this company has a clear purpose to advance that where people live and work. And despite the challenges, we continue to support the communities we are in.

So, again, thank you again for joining the call today. And I hope you continue to stay safe and healthy. And talk to you soon.

Andrew Simanek
Thanks, everyone. Operator, I think we can go ahead and close out the call.

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