Hewlett Packard Enterprise

Third Quarter 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

Antonio Neri - *President, Chief Executive Officer*

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

Andrew Simanek - *Head of Investor Relations*

PRESENTATION

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

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

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

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

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

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

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

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

Antonio Neri
Thanks, Andy. Good afternoon, everyone. Q3 was another strong quarter for Hewlett Packard Enterprise. We delivered solid results across all key financial metrics. We grew revenues and we significantly expanded operating margins. We also delivered EPS well above our outlook and generated strong cash flow.

Our focus on shifting our mix to higher-value growth areas while optimizing our volume business is working. This is supported by excellent execution of HPE Next, our initiative to re-architect

the company from the ground up with a goal of driving better operational efficiency and effectiveness.

Even as we focus on new growth areas, we continue to deliver solid performance across each of our business segments. This, combined with the market momentum, will enable us to deliver fiscal year '18 revenue and earnings well above our original outlook provided at securities analyst meeting last year. In Q3, we delivered revenue of $7.8 billion, up 4% year-over-year, driven by balanced performance across Hybrid IT, Intelligent Edge and Financial Services with particular strong growth in Intelligent Edge segment.

We also continued to strengthen our profitability by focusing on the high-value segments of the market, while improving efficiency through our HPE Next actions. In Q3, we achieved non-GAAP operating margins of 9.6%, up 270 basis points from the prior year. As a result, we delivered strong EPS growth in Q3. Non-GAAP EPS of $0.44 doubled from a year ago and is well above our outlook range of $0.35 to $0.39. From a free cash flow perspective, we delivered $751 million and are well on track to deliver $1 billion in free cash flow in fiscal year 2018.

Turning to the business segments; in Hybrid IT, we have the right strategy and in a healthy IT spend environment, we are executing well, and it is showing up in our results. After a strong first half, we continued to see solid growth with revenue of $6.2 billion, which is up 3% year-over-year or up 5% year-over-year, excluding the tier 1 segment.

The operating margin expanded 270 basis points to 10.6% from a greater mix of Gen10, improved pricing and savings from HPE Next. We're also gaining share in the higher margin, high-growth segments like software-defined infrastructure, high-performance compute and mission-critical systems.

In compute, ISS core grew 10% year-over-year due to continued market demand and accelerated mix of Gen10, and better options attach, which helped drive improved average unit pricing. This is more than offset in the decline in tier 1 commodity server sales, as we intentionally exit that type of business.

Our hyperconverged segment, which now includes appliances, infrastructure and our composable offerings, grew over 130% year-over-year and has reached an annual run rate of more than $1 billion. HPE Synergy delivered record revenue and has more than 1,600 customers.

Finally, high-performance compute is another area of strength. Revenue was up 9% year-over-year and we continue to be the market leader with roughly 35% market share. We have strong momentum across both public and increasingly, private sector deployments.

For example, in Q3, we announced a new development in our long-standing relationship with the U.S. Department of Energy to build a new supercomputer for the National Renewable Energy Laboratory. The new system named Eagle, will run detailed models that simulate complex processes to advance early research and development of renewable energy technologies across fields, including vehicle, wind power and data sciences.

Outside of compute, storage revenue grew 1% year-over-year even with tough second half compares. At the same time, we saw 17% growth in big data storage. We expect improved organic growth in Q4 as we drive increased sales productivity and as our latest storage offerings

gain customer traction. For example, in July, we expanded our offering of HPE InfoSight across our 3PAR portfolio, which now enables intelligent all-flash storage for our customers. HPE InfoSight is our artificial intelligence platform that helps our customers operate more efficiently in an autonomous data center.

We also introduced the next generation of our HPE Nimble Storage platform that enhances the protection of our customers' investments and incorporates our store more guarantee, which provides customers with a significant upfront and long-term financial advantage by offering the industry's first guarantee of storage efficiency.

We continue to strengthen our HPE Pointnext services business, and we see significant opportunity as we execute our services-led go-to-market strategy. In Q3, HPE Pointnext revenue was down 1% year-over-year, but overall orders grew 4%. More importantly, our most profitable operational services business grew 1%, with orders up 8%. This growth is largely due to strong improvement of services intensity as we shift our focus in more value-added offerings, high-growth in HPE GreenLake and some larger deals.

Advisory and professional services revenue was down 10%, largely due to our intentional exit of more than 40 companies as part of our HPE Next plan, and we continue to invest in new services capabilities. For instance, at HPE Discover in Las Vegas, we announced our next generation of HPE GreenLake hybrid cloud to help our customers optimize their hybrid cloud operating models.

By eliminating the need for staff to manage their hybrid environments day to day, the new HPE GreenLake solution enables them to focus on innovation. Overall, our Hybrid IT portfolio of products and services is stronger than it has ever been, and continues to help our customers manage and simplify their IT in a hybrid world.

Turning to the Intelligent Edge segment, performance remains strong with revenue of $785 million, up 10% year-over-year. We saw particular strength in our campus segment, driven by our secure cloud offerings. Looking forward, Intelligent Edge is a significant long-term growth opportunity for us, and therefore a key area of investment. I said that because there is a major transition happening right now, driven by the explosion of the data created at the edge. The edge is the word outside the data center. And Gartner says, 75% of the world's data is generated at the edge.

I am certain that the rise of Intelligent Edge is the next great market transition coming. And HPE is uniquely committed to and build for this transition. We already have a competitive advantage at the edge with Aruba, pioneering networking with HPE's deep history in continued innovation and compute storage and services.

That is why we recently announced that we plan to invest $4 billion in this segment over the next four years. Two good examples of the innovation we are driving in Intelligent Edge are Aruba's new software refined branch solution and our converge OT-IT edge solutions. We see a world that is acentric cloud-enabled and data-driven and our portfolio of intelligence edge solutions is resonating with customers.

In Q3, Aruba won significant new deals with customers, including Caesar's Entertainment, which will roll out Aruba wireless LAN across their large public venues and a deal with the University of Arkansas where Aruba will completely replace the existing network and system, including software and security. We've also seen strong traction with our Edgeline system in industrial

IOT applications. For example, a leading auto manufacturer is deploying these systems that pioneer the convergence of operational technologies and enterprise-class IT functions all in a single solution. This new integration is allowing customers to reduce cost in the manufacturing operations while increasing production rates.

Finally, HP financial services had another strong quarter delivering revenue of $928 million, up 3% year-over-year with strength in our asset management business. Financial services remains a consistent and predictable business for us as customers continue to look for flexible, alternative ways to consume and finance their technology needs. In addition to strong business performance, our efforts with HP Next continue to pay off as we build on the progress we made in the first half of the year.

For example, in order to improve our operations we have significantly simplified our portfolio by reducing our compute platform by nearly 60% and our options by nearly 80% bringing our total live SKUs down by about 75%. We're already starting to see the benefits of these efforts show up in our results as the simplification is driving more focus and lower costs.

In our supply chain, we are constantly updating our manufacturing sites and have already reduced the locations by more than half. This has cost us around facilities, test equipment as well as planning and product setup costs. We also completed a final wave of transition to partner-led mobiles in 11 countries in Europe, Middle East, and Africa which enable us to continue to serve these markets with our valued partners while we focus on improving our execution in the markets that drive 99.5% of our revenue. Finally, we have also continued to invest in innovation with an emphasis in Intelligent Edge, software-refined, artificial intelligence, and cloud-enabled technologies.

Overall, I'm pleased with our performance in the quarter. We continue to execute against our strategy, which is clearly resonating with customers. I am excited about the company position and against our strong market backdrop, we are well on track to meet or exceed our full-year financial commitments as we continue to focus on delivering for our customers and partners in driving significant shareholder value.

Now, before I turn over the call to Tim, let me address the other news we announced today. After four and a half years of the company during a period of incredible transformation, Tim is stepping down at the end of our fiscal year. Tim played a significant role in turning HP around and contributing to the largest separation in corporate history as we launched Hewlett-Packard Enterprise. He has helped us demerge two major businesses, which delivered more than $20 billion of transaction value and has overseen the completion of 11 acquisitions. Tim has been an incredible partner, advisor, and friend to me as we now begin the tremendous change together.

As I said in our announcement, Tim has helped make HP's future possible. We are very well positioned for future success because of Tim's leadership and commitment to this company, our employees, and our shareholders. Tim will remain with the company through the end of October 2018 to help ensure a smooth transition to Tarek Robbiati who will join us as our new CFO effective September 17. You will have the opportunity to meet Tarek at our securities analyst meeting at the New York Stock Exchange on October 24th. Tarek is a seasoned executive with significant global experience managing both business and financial strategy and operations at public and privately held companies within the telecommunications, media, technology, and financial services industries.

He most recently served as a CFO at Sprint Corporation where he was responsible for all finance functions as well as mergers and acquisitions and business development. He drove Sprint's transformation efforts to significantly reduce operating expenses and he played a strategic leadership role and repositioned the company ahead of its [indiscernible] merger with T-Mobile. HP will benefit from Tarek's financial expertise, his customer-centric mindset, and his industry segment knowledge.

I look forward to partnering with him as we continue to execute against our sound strategy that Tim helped us create. I am tremendously grateful to Tim for all he has helped us achieve and it is my pleasure now to turn the call over to him to provide additional details about our performance and financial outlook. With that, I will turn over to Tim.

Tim Stonesifer
Thanks, Antonio, for the kind words. Our Q3 financial results were strong with good revenue growth, significantly improved operating margins, better than expected earnings, and a healthy cash flow.

Total revenue for the quarter was $7.8 billion, up 4% year-over-year and 1% in constant currency. Top line performance was driven by solid execution and good market dynamics that we expect to continue. From a portfolio mix perspective, we continue to drive good growth in our value offerings and our core volume business continues to grow better than expected. From a macro perspective, IT spending continues to be healthy with robust customer demand.

The market remains competitive but pricing remains rational and we continue to pass through commodities cost. DRAM cost increases appear to have peaked and NAND prices while less of an impact on our portfolio, have become more favorable. Currency drove a 230 basis point tailwind to revenue year-over-year. Foreign exchange rates have continued to move unfavorably, so we will not have as large of a tailwind in Q4 and expect less than one point of benefit to revenue in Q4 if current rates hold.

Regionally, HPE's performance was solid around the globe. America's revenue was down 3% in constant currency but grew 1% excluding tier one business. Both core compute and edge grew 10%. Revenue growth in EMEA continued to be strong, up 3% in constant currency with particular strength in the UK, France, and Italy. Performance in EMEA was good across all business units, particularly in compute and data center networking. Asia-Pacific grew 6% in constant currency with double-digit growth in Japan and Australia. Growth in APJ was also solid across all business segments with notable strength in compute and edge.

Turning to margins; the gross margin of 30.7% was up 140 basis points year-over-year and 30 basis points sequentially. Non-GAAP operating margin of 9.6% was up 270 basis points year-over-year and 100 basis points sequentially. Pricing was favorable this quarter as we focused on improving compute margins and we no longer face significant headwinds from commodity costs. We also delivered the expected savings from HPE Next.

Looking at the full year, we'll continue to take advantage of healthy demand and grow our volume business much better than I expected, which optimizes our operating profit. We now expect the fiscal year '18 and non-GAAP operating margin to be just over 9% compared to our prior 9.5% target.

Longer term, we will continue to expand margins by driving further cost savings from HPE Next and improving the mix of our value portfolio, which has higher margins and Pointnext services

attach. Non-GAAP diluted net earnings per share of $0.44 is well above the high end of our previous outlook of $0.35 to $0.39 due to strong operational performance, favorable one-time benefits in OI&E, and a lower than expected tax rate. The Q3 non-GAAP tax rate was 8%. This is below our previously provided tax range of approximately 11% due to a favorable shift in the mix of earnings and the delay of certain tax expense from Q3 now expected in Q4.

Consequently, we expect our Q4 tax rate to be elevated, but still come in at approximately 11% for the full year aligned to our prior guidance. GAAP diluted net earnings per share was $0.29, above our previously provided outlook range of $0.19 to $0.23 primarily due to the same reasons as the non-GAAP results.

Now turning to the business units, in Hybrid IT revenue was up 3% year-over-year and flat in constant currency. Operating margins were 10.6%, up 270 basis points year-over-year and 30 basis points sequentially and in line with our expectations. Compute revenue was up 5% year-over-year and 10% excluding tier one. We saw continued momentum in our value business with hyper converge and synergy up triple digits and mission-critical growing 10%.

Revenue growth in our core volume business was once again higher than planned driven by strong growth in core rack and tower. Also, we continue to drive higher AUPs in core compute up over 25% by increasing our mix of Gen10 servers with richer attachment configurations, improving pricing and to a lesser extent passing through elevated DRAM costs. Structural AUP increases which exclude elevated DRAM costs made up more than 75% of the total increase and more than offset core unit declines which moderated to low double-digits this quarter.

Looking forward, we expect unit declines to moderate which will continue to be offset by structural AUP increases, driven by an increasing mix of Gen10 which is now just over 50% of the portfolio and continues to ramp. Storage revenue was up 1% year-over-year as we faced tougher second half compares. With that said, big data had another strong quarter with high double-digit growth and entry storage growth was also solid.

Looking forward into Q4, we should start seeing the benefits of the increased number of new sales specialists that we hired earlier in this year. And as Antonio mentioned, we are excited about the recent enhancements we've made to our offerings, particularly with HPE's InfoSight platform that has been extended to the 3PAR portfolio. Given this, we expect the growth rates in storage to pick up next quarter.

Data center networking revenue declined 6% in the quarter as growth rates can vary on a quarter-by-quarter basis from the smaller business, but we still expect to deliver solid growth for the full year.

HPE Pointnext revenue was down 1% year-over-year but orders were up 4% year-over-year with operational services orders up 8% that included a few large deals. As you think about the relationship between orders and units, keep in mind that roughly 25% of total Pointnext orders are related to new attach. And in new attach, we have been shifting our focus to more value-added offerings that drive up services intensity which was up nearly 20% year-over-year. We are also growing other non-attach services like our consumption based offerings with HPE GreenLake which was up over 40%. As a result, we have more than offset recent unit declines and grown operational services orders, our most profitable business, for three consecutive quarters.

In the Intelligent Edge, revenue was up 10% year-over-year and 8% in constant currency with strength across all regions. Operating margins of 11.6% were down 300 basis points year-over-year due to significant investments in sales and R&D, but up 510 basis points sequentially due to the operating leverage from higher revenue. Aligned to our strategy of pivoting to the Intelligent Edge, we have been making significant investments that have given us a leadership position in this high-growth market opportunity.

Aruba product grew 10%, with continued strong growth in campus switching and edge compute. Aruba services was up 14% on continued installed base growth due to strong attach of our software platform like ClearPass and AirWave.

HPE financial services revenue grew 3% year-over-year and 3% in constant currency, driven by strong residual sales and solid growth in our direct business. Volume remained strong, up 15% year-over-year across all regions and with growth in both our direct and indirect business. Operating profit increased 20 basis points year-over-year to 7.9%.

Now, turning to cash flow; free cash flow was $751 million in Q3. The cash conversion cycle was in line with expectations and decreased sequentially by one day to negative 23 days. We expect our cash conversion cycle to show improvement in Q4, similar to last year, as we further bring down inventory levels following strategic positioning of key commodities in prior quarters. We also expect cash earnings to be higher in Q4 and are well on track to achieve our free cash flow outlook of $1 billion in fiscal year '18. We ended the quarter with an operating company net cash balance of $3.2 billion.

Moving to capital allocation, as part of our continued $7 billion capital return plan through fiscal year ‘19 which we announced in Q1, we returned $1.1 billion to shareholders during the quarter. This includes the previously announced 50% dividend increase, totaling $170 million in dividend payments. We repurchased $936 million in shares in the quarter and will likely exceed our $3.5 billion buyback target for fiscal year ‘18 as we look to buyback shares opportunistically.

Now, turning to our outlook; as a reminder, we started the year with a fiscal year ‘18 outlook of the $1.15 to $1.25. In the past two quarters, we’ve raised our outlook for operational performance we delivered in the quarter and onetime benefits. We will do that again in this quarter by passing through our Q3 operational upside and benefits and OI&E, plus we will pass through additional operational outperformance in Q4 as we remain confident in our execution against a good market backdrop. As a result, we will increase our fiscal year ‘18 non-GAAP diluted net earnings per share to $1.50 to $1.55, and we expect fiscal year ‘18 GAAP diluted net earnings per share to be at $1.85 to $1.90.

So overall, I am pleased with the performance in the quarter. This was our third consecutive quarter with operational outperformance and another proof point to the strength of our strategy and financial architecture laid out for you at the security analyst meeting in 2017. I am looking forward to closing out the fiscal year with another strong quarter.

Now, before we open up the call for questions, I would just like to say, it’s been a privilege to be part of this team and I am incredibly proud of what we’ve accomplished.

As I reflect on my time as a CFO, we launched HPE, we repositioned the portfolio with the ES and software spin mergers. We accelerated our strategy with multiple acquisitions while returning $10 billion of cash to shareholders and we created a significant amount of value. This

year, we made great progress on HPE Next and we've met or exceeded all of our key financial commitments.

I would like to say thanks for Antonio for being a great business partner, to Meg Whitman for giving me this opportunity, to the board for all their insights during this transformation and most importantly to all of my HPE colleagues for their support and dedication to make all this happen. The company is in an excellent position to continue to deliver.

Now with that, let's open it up to questions.

QUESTION AND ANSWER

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

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

Katy Huberty
Thank you. Good afternoon. How much of the $0.07 EPS beat this quarter would you attribute to operational or execution factors versus some of the one time and tax benefits? Given the guidance increase just flows through that 3Q beat, why not assume that that execution continues? Then, I have a follow-up on servers.

Tim Stonesifer
Sure. Thanks, Katy. So as far as the beat goes, I would say $0.02 of that was operational, $0.03 was driven by some favorable OI&E which was driven by primarily FX and then another $0.02 was driven by the favorable tax rate which is really just going to be a shift between Q2 or Q3 and Q4.

Now when you look at the total year though, going from the $1.40 to $1.50 up to where we are, I would say $0.02 of that was the operational improvement in Q3 which to your point, we passed through consistent as in prior quarters, $0.03 of that is the OI&E onetime benefit, but we are flowing through another $0.02 of operational improvements because we do expect to continue to execute in Q4 along with a good market backdrop.

Katy Huberty
Then, as we think about the server business, will revenue growth in the foreseeable future come entirely from mix shift and AUP increases or do you have any line of sight into units stabilizing year-over-year even returning to growth over the next year?

Antonio Neri
Yes. Good afternoon, Katy. This is Antonio. Yes, we expect to continue to grow the business, despite the fact that we continue to deemphasize our focus on that commoditized server business. This quarter, as you can see, we grew the business 5% and if you take the tier 1, up 10%. The reason why it's because obviously the demand is there, and ultimately the strategic growth categories continue to grow at a healthy space, and we continue to gain share in this particular segment. Then, last but not least, we have made structural changes in our AUPs and

maybe Tim can reinforce that comment because he made the comment that 75% of that AUP increase was driven by structural changes.

Tim Stonesifer
Yes. Again, our definition of structural is excluding everything that's associated with the pass through of increased commodity costs. As you look going forward, I would expect to continue to see structural improvements, primarily given by the fact that one, we are going to continue to attach to richer configs, and if you look at the Gen10 server mix today, it's roughly just over 50% of the overall portfolio. There is still room to grow there; I'd expect that to offset any unit pressure that we see going forward.

Katy Huberty
Thank you. Good luck, Tim.

Tim Stonesifer
Thank you.

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

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

Sherri Scribner, your line is open on this site. You may be muted.

Andrew Simanek
I think she got disconnected, sorry.

Operator
Okay. We will go on to the next question. It will be from Toni Sacconaghi of Bernstein. Please go ahead. Sherri Scribner, your line is open on this site. You may be muted.

Andrew Simanek
I think she got disconnected.

Operator
Okay. We'll go on to the next question.

It will be from Toni Sacconaghi of Bernstein. Please go ahead.

Toni Sacconaghi
Yes. Thank you. It sounded like you felt you had a lot of profit tailwinds in the Hybrid IT segment this quarter, excellent execution on HPE Next, DRAM pricing environment, better structural price improvements and volume sequentially was up a couple hundred million and also, your mix of tier 1 was down which should have helped. In light of those things, why did we not see more sequential improvement in operating margins in Hybrid IT? I have a follow-up, please.

Tim Stonesifer
Yes. Again, if you look at the sequential improvements overall, it was driven by those things. If you look at the mix improvement, if you look at some of the...as we right-size across

acquisitions, as we deliver the HPE Next. That was in line with our expectations. Keep in mind; we did do some recent acquisitions. There is a little bit of incremental OPEX in there as we take that into the system. Overall, we were pleased with our margin improvements. Again, this is a plan that has been built on that. We talked about that going back to Q1 and we see nice expansion in Q2, Q3, would expect that to continue in Q4.

Toni Sacconaghi
Then, I just have two minor clarifications. Your tax rate, you're expecting to be 11% for the full year. I think, at the end of Q1, you said you expected your tax rate next year to be 16% to 20%. Should we still be thinking about that or are there discrete structural changes? Then, could you clarify what server unit growth was in total, and then ex tier 1 please?

Tim Stonesifer
Yes, so as far as the tax rate goes, we would expect it to still be in that 16% to 20% range. Then, from a unit...what was the second question?

Antonio Neri
The second question was total unit growth. Toni, on that one, Tim made a comment in his remarks that the total units when you add everything, it was actually down low double digits. It's an improvement quarter-over-quarter, and we continue to see that moderate obviously on the growth areas that we are emphasizing. That's mostly driven because of the tier 1, as we exit, year-over-year. We are emphasizing and growing the aspects of the other portfolio. I think, as we go forward we expect that to moderate and stabilize, and then continue to drive the structural price changes that we saw this quarter, which we expect to continue.

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

Operator
The next question will be from Rob Cihra of Guggenheim Partners. Please go ahead.

Rob Cihra
Hi, thanks very much. Just asking…it was mentioned a couple of times; you expect your storage growth to improve next quarter. And I'm just wondering, apart from slightly easier compare, what's driving that? Is that market; is that HPE specific as you move past the Nimble acquisition now? Thanks.

Antonio Neri
Sure. This quarter, we grew storage as a segment 1%. When you look with the combination of that segment plus the other platforms, including hyperconverged and composable, actually total growth is 12%. And within that also, we saw big base of storage growing 70%, because that's the demand, so, we see the explosion of data continue.

You have to store the data somewhere. Obviously more hybrid cloud capabilities are needed going forward. That's the beauty about our Nimble platform, which provides cloud volume, so you can move data back and forth between on-prem and off-premises provide an intelligent proper with HPE InfoSight. We expect the combination of the data growth, plus our increased productivity in our sales force, plus the differentiation of the portfolio to continue to accelerate the growth in storage. Obviously, each sub segment of that storage segment will play differently. But we are very confident about our ability to grow storage because we have a differentiated portfolio, very autonomous in many way, self healing. Then ultimately, we

introduced new platforms now, as customers get more acquainted with those platforms, we believe we have a true value differentiated offer in the market.

Rob Cihra
Alright, great. Thank you.

Andrew Simanek
Great. Thanks Rob. Could we move on to next question, please?

Operator
Your next question will be from Simon Leopold of Raymond James. Please go ahead.

Simon Leopold
Great. Thanks for taking the question. I appreciate you reiterated the target for the full year free cash flow generation of $1 billion. I think, what I'm trying to understand is how much of the pattern we observe on a quarterly basis is abnormal versus what you would think is normal, because it looks like you're generating much of that target in the fourth fiscal quarter. Really, my objective here is to think about the longer term free cash flow generation. Maybe help us think about puts and takes around that trend.

Tim Stonesifer
Sure. Free cash flow is a tough one to model because of the complexity of the balance sheet and the timing. The way I would think about it, as we've discussed before, when you look at this business and you go back the last couple of years, and '18 is no different, the first half of the year, we consume a lot of cash and the second half of the year we generate a significant amount of cash. And the profile has been pretty consistent, if you go back to prior years. And that has a whole host of reasons. I think the trends that we're having are consistent. If you look at Q3, we generated $751 million. We're now, if you look at quarter to date, its $70 million for the year. Between cash earnings and then some continued improvement in our cash conversion cycle, we ended Q3 at negative 23 days. We'd expect to be at the high negative 20-day range in Q4, very similar to last year. Those are the dynamics. I wouldn't expect that to really change as we go forward.

Simon Leopold
Great, thanks. And just as a quick follow-up. I wonder if we could get maybe a little bit of color commentary on your progress around hyperconverged infrastructure. Thanks.

Antonio Neri
Sure. We are very pleased with our progress in hyperconverged. Again, we grew the total segment 130% year-over-year, which is roughly 3 times the market. Our HPE SimpliVity platform continued to grow very, very, nicely driven by the efficiency of the software defined storage that's built into it with the industry leading HPE ProLiant server, which is the most secure server platform on the planet. In addition to our HP OneView, which is a software-defined data center infrastructure, which has significant capabilities in terms of provisioning, lifecycle management and more and more automated AI capabilities built into it. Also, let's remember that part of the hyperconverged as we move into what we call composable infrastructure, which is a superset of the hyperconverged, continues to grow very, very nicely. In fact, we grew triple digits, and now we have 1,600 customers on it. That's a platform we are very proud of the work we have done. Again, bringing the innovation that really matters for our customers, which already are looking to deploy infrastructure that's efficient and cloud like with

the same economics and the same way to consume it. That's why it's resonated with customers.

Simon Leopold
Great. Thanks for taking my questions.

Andrew Simanek
Great. Thanks Simon. We'll take the next question, please.

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

Rod Hall
Yes, thanks for the question. I wanted to just ask if you could give us any more color on why the Americas constant currency growth was down 3% in the quarter, and it's grown 4% in the last couple of quarters. So, would you be able to comment on what's happening there, considering it seems like a pretty strong enterprise spending environment? Then I have a follow-up.

Tim Stonesifer
Sure. So, if you look at the Americas, to your point, down 3%, if you look at tier 1, we have a significant amount of our tier 1 business is in the Americas. If you exclude that we were actually up 1%. If you look at compute, again excluding tier 1, we were up 10% in the Americas. If you look at edge as well, we're up 10% in the Americas. You really need to take the tier 1 into account there. Overall, we felt pretty good about our growth across all of our markets.

Antonio Neri
Yes, and I will say, most of the concentration of tier 1 where the bills were created and so forth, they're all in the mostly in the North America region.

Rod Hall
Okay. Thanks for that. And then, I wanted to just clarify your commentary around unit volumes and juxtapose that with the AUP commentary. I thought I heard you say that AUPs were up over 25%, but, I wasn't sure if that was for a total servers or some sub segment. Then revenues are up 5%, but you're saying that units are down low double digits. Can you just piece those together for me, so that it's clear what the AUP contribution and the unit contribution was for the total?

Tim Stonesifer
Yes, the 25% is related to core compute, and that was pretty consistent with what we did in Q2. Again, I think, the best way to think about it is if you look at the structural increases, so take out the effect of the pass through of commodity cost increases that attributes roughly 75% of the price increase. Then if you look at units in quarter they were down low double-digits. That's how you get to the numbers.

Rod Hall
Okay. Thanks a lot.

Andrew Simanek
Okay. Thanks Rod. Next question, please?

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

Ananda Baruah
Hi, good afternoon, guys. Thanks for taking my question. Two, if I could. The first is, just with regards to Next and the ongoing benefit from mix in the core business, f you sort of flow the numbers through that you provided at the analysts day for Next through next year, so fiscal 2019. Then, even holding all else equal, it would suggest potential for pretty nice jump up in op income dollars in '19 from '18. Then, given how well you have done repositioning the business mix et cetera, Gen10 in '18, it would seem there would be a little more lift behind that. What would be the reason? That's anecdotal, what would be the reason that maybe we would not be positioned to see a nice lift up in '19 EPS, from '18 EPS? Then I have a follow-up. Thanks.

Tim Stonesifer
Sure, we are going to give you a plenty of color on ‘19, next month at the security analyst meeting, or in two months, but here is a couple of things to think about. The levers to your point, as you look at ‘19 versus ‘18 will be very similar to what we laid out at the security analyst meeting last year. HPE Next, that will drive some nice improvements in ‘19 from a year-over-year basis as we continue to make progress on that initiative and we are well on track and that should be somewhat aligned to what we saw this year. Mix will also play an impact, so we are going to continue to mix up and grow the higher margin pieces of the portfolio. We’ve got some nice traction in ‘18 we would expect that to continue in ‘19, particularly against a good market drop. FX you can look at the rates today and look at where we were before that will probably, if those rates hold, that would be a headwind as you go into ‘19. So take that into account.

OI&E, we’ve had a few onetime benefits this year. We had one in Q1 we just talked about one in Q3. I would take that into account as you look at a year-over-year view. I think rates are higher now than they were before. I would take that into account as well. Then, we’ll see some pressure on the tax rate, because if we come in as expected between that 16% to 20% rate as compared to the 11% rate this year that will be a pressure point.

Then, lastly, share account. Share account should be favorable next year as it was this year. Again, we are going to give you all that color at the security analyst meeting but those are the levers that I think about.

Antonio Neri
I will say, just a comment here, I think Tim did excellent job in articulating the financial view of this. I have to say, I am incredibly proud of the work that we have done. We’re executing HP Next further plan and they are executing well, despite all the transformation we are driving.

Ananda Baruah
Thanks for the detail. Tim, just quickly, I would love your view on normalized free cash flow. At Discover, you guys gave for the first time a number related to the dynamics that you’ve been talking about for a few quarters, the $1.5 billion. Could you just talk a little bit about normalized free cash flow and how we should think about that and when we can expect you guys to get there? Thanks.

Tim Stonesifer
Yes. Again, we’re going to lay all that out at the security analyst meeting. Our view is still our normalized free cash flow is in the $2 billion range. We will not get there next year, as we’ve talked about because we have charges related to HPE Next which again are critical to

transforming this business and positioning us for success going forward, but we'll give you plenty of detail at the security analyst meeting.

Ananda Baruah
Got it, thanks a lot, appreciated.

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

Operator
Certainly, and that will be Aaron Rakers of Wells Fargo. Please go ahead.

Aaron Rakers
Yes. Thank you. And Tim, congratulations, I wanted to go back to the ASP discussion a little bit and take it a little differently. If you just isolate out the 25% out of the 75% that's related to component pricing, and I am curious of how you see the environment progressing over the next couple of quarters. Whether or not we should be assuming that that you have to start to pass through the possibility that component pricing starts to decline and your customers start to ask for that to be given back on the ASP side?

Tim Stonesifer
Yes, certainly now, if you look at DRAM costs, they've certainly moderated and we are passing through those incremental costs. I think going forward, if this thing was to move in a different direction, I would expect that to be passed through as well. My experience in prior industries is that when commodities go down, it's a little bit easier to hold on to them on their way down. So we should get a little bit of benefit from that. We will see what happens. The other big thing too is, what are our competitors doing and what is the competitive pricing landscape out there if that were to happen.

Aaron Rakers
Okay and then as a real quick follow-up, I apologize if I missed it, but, you talked a little bit about storage and storage coupled with HCI, but I think in the past you've provided some metrics around the growth of your all-flash business. I was curious if you could provide that this quarter.

Tim Stonesifer
Yes, we typically don't break that out. All-flash is, to your point, the overall storage, but we keep it at the overall storage level.

Aaron Rakers
Okay, fair enough. Thank you.

Andrew Simanek
Thank you, Aaron. Move on to the next question, please.

Operator
Certainly, it will be Jeff Kvaal of Nomura Instinet. Please go ahead.

Jeff Kvaal
Yes. Thank you very much for taking the question. I wanted to first follow-up on Rod's question about the decline in the Americas. You cited the tier 1s. Does that imply that the run off of the tier 1 customers has picked up and how much of that is left to go?

Antonio Neri
This was at the peak, remember, we said this was 15% of our total compute business. There is still some way to go. Remember that there is seasonality in that business based on when the build outs of these large hyperscale business center took place. We still have some business and we are transitioning that business as we speak. As I said before, most of those build-outs are actually in the United States.

Jeff Kvaal
Okay. Then, secondly, as a follow-up, can I ask, we haven't talked about tariffs yet. I am wondering if you have some thoughts on what might happen in the tariff landscape, and how you might be preparing for various eventualities and how we might want to prepare for various eventualities?

Antonio Neri
Sure, this is a very complex topic. Let's say most of the U.S. tech firm relying on complex supply chain and HPE is not different. This system, call has been built over many decades. We need to understand the details, honestly, it's too early. We don't have the full details, obviously we are providing inputs in the right forums. We believe there is different ways to address this problem, but from our vantage point, we are looking at scenarios depending on where this is going to land. Once we have the details, we will let you know if there is an impact or not. We have already maneuvered through two different iterations of this, we're able to do good job in mitigating the latest one we still have to wait till the end of September to see what happens.

Tim Stonesifer
Yes, just to give you some financial context around that, less than 5% of our total cost of sales envelope comes directly from China. It's a big number, but it's not a huge number. To Antonio's point, after rounds one and two, we have been able to make some changes in our supply chain motion and think there is minimal risk from a financial perspective.

When you look at rounds three and four, that would impact the half of that 5% that I just mentioned, that's really going to be dependent on do they go with 10% or 25%. It will be dependent on whether we can make any more changes in our supply chain motion. And the other thing to keep in mind is this is not just an HPE thing, this is an industry thing. So how will the competition in the industry respond with regards to passing that through on the pricing front? So we think its minimal impact at this stage but to Antonio's point, we are keeping an eye on it to make sure we understand the changes.

Jeff Kvaal
Great. Thank you both very much.

Andrew Simanek
Great, thank you. I think we have time for one last question, please.

Operator
That will be Paul Coster of JP Morgan. Please go ahead.

Paul Coster
Thank you for taking my question. You are in investment mode, as far as the Intelligent Edge is concerned. You must be under earning in that segment. Could you give us some sense of how

much you are under earning by, whether it's in terms of margins or dollars? Then I have a follow-up.

Tim Stonesifer
Yes, sure. If you look at Q3, you will note that in edge that our margins were down about 510 basis points. That is primarily driven by the fact that we are investing in sales and in R&D. Again, the edge is a key pillar to our strategy that's going to be a high-growth, high-margin opportunity for us and we are going to continue to invest there. Now, what I will note is, if you look at it sequentially, they are up. They are up 510 basis points, so I think they are down 300 basis points year-over-year. They are up 510 basis points sequentially which just shows you that that operating leverage and that revenue leverage is important, given the margin profile in that business.

Paul Coster
Can you give us some sense of what it is you are investing in? I am particularly interested in the probable convergence of your technology with point-to-point, point-to-multipoint.

Antonio Neri
Sure. Obviously we have a very strong platform with Aruba and which provides connectivity, but, it's also a mobile first, cloud first platform, and what we are doing there is invest in security and cloud consumption based models and analytics. Those are the three big areas. If you think about the type of organic and inorganic investments we read in the last, let's say, 18 months with acquisition of Niara which provides now AI security embedded in our platform or whether it's Cape Networks or even RASA Network, they are all geared into that direction. So there is to continue to expand the adjacency around the core campus and really provide the digital platforms that customers are looking for.

Then, on the industrial side, obviously, we see now new use cases in term of IoT applications which customers are looking the convergence of what we call operational technologies and enterprise IT class technologies because ultimately, much of that data in the industrial space is analog data which has to be digitized and then analyzed. In that space we see the opportunity to bring what we call edge computing closer what the data is generating and yet provide [technical difficulty] for customers to deploy this new framework. We see that continue to grow, and it's going to be very industry driven and obviously very use case driven.

Paul Coster
Thank you. That makes sense.

Andrew Simanek
Great. Thank you, Paul. I think with that we can wrap up the call for today. Thanks, everyone, for joining.

Antonio Neri
Thank you.

CONCLUSION

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