Hewlett Packard Enterprise

Third Quarter Fiscal 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

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Tarek Robbiati - *Chief Financial Officer*

Andrew Simanek - *Vice President, Investor Relations*

PRESENTATION

Operator
Good afternoon and welcome to the Third Quarter Fiscal 2021 Hewlett Packard Enterprise Earnings 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 a listen-only mode. We will be facilitating a question and answer session toward 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'm Andy Simanek, Head of Investor relations for Hewlett Packard Enterprise. I'd like to welcome you to our fiscal 2021 third quarter earnings conference call with Antonio Neri, HPE's President and Chief Executive Officer, and Tarek Robbiati, HPE's Executive Vice President and Chief Financial Officer. Before handing the call over to Antonio, let me remind you that this call is being webcast. A replay of the webcast will be made available shortly after the call for approximately one year. We posted the press release and the slide presentation accompanying today's earnings release on our HPE investor relations web page at investors.hpe.com.

As always, elements of this presentation are forward-looking, and are based on our best view of the world and our businesses as we see them today. For more detailed information, please see the disclaimers on the earnings materials relating to forward-looking statements that involve risks, uncertainties, and assumptions. For a discussion of some of these risks, uncertainties, and assumptions, please refer to HPE's filings with the SEC, including its most recent Form 10-K 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 HPEs quarterly report on Form 10-Q for the fiscal quarter ended July 31st, 2021. Also, for financial information that has been expressed on a non-GAAP basis, we 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, we will be referencing the slides in our earnings presentation throughout our prepared remarks. As mentioned, the earnings presentation can be found posted to our website and is also embedded within the webcast player for this earnings call.

With that, let me turn it over to Antonio.

Antonio Neri
Thanks, Andy. Good afternoon, everyone. Thank you for joining our call today. I am amazed by the resilience of our customers, partners, and team members. And I'm incredibly proud of the way Hewlett Packard Enterprise continues to serve the needs of our global communities during such unusual and evolving circumstances. We delivered a very impressive third quarter

at HPE with strong orders growth, expanded margins, and record free cash flow. Overall, I am pleased to see how our differentiated portfolio is resonating with the market. And our edge-to-cloud strategy is driving improved momentum across our businesses. Based on the strength of our Q3 performance, and our confidence about our momentum in the market, we are again raising our fiscal year 2021 EPS and free cash flow outlook, and we are also resuming stock repurchases.

Revenue in Q3 was $6.9 billion, in line with our outlook and normal sequential seasonality. Our Q3 orders were up strong double-digits year-over-year, and our year-to-date order volume has increased 11%, showing the strength of our edge-to-cloud offerings. We significantly expanded our non-GAAP gross and operating margins, driving our year-to-date non-GAAP operating profit and earnings per share up 28% and 27% year-over-year, respectively. We generated a record year-to-date free cash flow of $1.5 billion, up $1.1 billion year-over-year, putting us well ahead of the original outlook we announced last October.

I am particularly pleased that we were able to deliver these results while mitigating against industry-wide supply constraints, by taking proactive inventory measures, working closely with our suppliers, and deploying our best-in-class engineering capabilities to establish specific response plans. The impact of the pandemic continued to accelerate the shift we predicted years ago, to an edge-centric, cloud-enabled, and data-driven world. Now, more than ever, there is a greater need for secure connectivity, faster insights from data, and a cloud experience everywhere. We expect these trends to continue.

Digital transformation is no longer a priority, but a strategic imperative. To help our customers transform their businesses and be future-ready today, we have been focused on doubling down in key areas that are resonating strongly in the market. We had a record number of orders in both our Intelligent Edge business and High Performance Computing and Mission-critical Solutions business. Due to strong demand and execution, these growth businesses now make up nearly 25% of our total company revenue. Our Intelligent Edge business accelerated its momentum again in Q3 with 23% year-over-year revenue growth driven by a record number of new orders.

Strong customer demand for secure connectivity has generated a backlog five times greater than at the close of Q3 last year, as customers increasingly look for solutions to collect, connect, analyze and act on data at the Edge. We are leaning into this demand, and continue to invest and innovating the edge. In June, we announced new AIOps, IoT, and security features for our Aruba Edge Services Platform or ESP, designed to streamline network operations, maximize IP efficiency, and more easily extend the network from the Edge to the Cloud. Our Aruba ESP continues to gain traction with customers in different verticals.

In the third quarter, customers including Save a Lot, Monument Health, and Circa Resorts and Casinos, all standardized their networks on Aruba ESP. In our High Performance Compute & Mission Critical Solutions business, revenue was up 9% year-over-year, driven by a record number of new orders. We also generated a record order book, which now exceeds $2.5 billion. The exponential growth in data, along with AI and big data analytics all are driving an increased need for high-performance computing and mission-critical capabilities in enterprises of all sizes.

To meet this demand, we bolstered our artificial intelligence capabilities with the acquisition of Determined AI, have stepped-up the deliveries a powerful software stack that would train AI mobiles faster at any scale using its open-source machine learning platform. We also continue to see an increasing number of customers accessing our high-performance computing solutions as-a-service through HPE GreenLake. With our HPE GreenLake cloud services for HPC, customers gain powerful, specialized computing, and AI capabilities with a sustainable cloud experience. For example, in Q3, HP was awarded a $2 billion contract to be realized over a 10-year period with the National Security Agency to deliver high-performance computing solutions through the HP GreenLake platform. The service will help the National Security Agency efficiently process data and allot new insight in sustainable new ways.

Our core businesses generated robust year-over-year orders growth, as well as strong profitability and free cash flow in the quarter. Year-to-date, computer storage orders are up mid-single-digits, with Q3 operating margins of 11.2% and 15.1%, respectively. We continue to offer more of our core capabilities as-a-Service. In Q3, we introduced unified compute operations as-a-Service throughout HP GreenLake edge-to-cloud platform. This new cloud-based management service simplifies provisioning and automates the management of computer infrastructure wherever it resides.

Our storage business is transforming into a cloud-native, software-defined data services business through organic innovation and targeted acquisitions. In May, we introduced our new cloud data services available through HPE GreenLake, as well as our new HPE Alletra cloud-native data infrastructure. And just this week, we closed the acquisition of Zerto, an industry leader in cloud data management and protection, and [indiscernible] of data recovery services, which will be soon available as-a-Service through HPE GreenLake.

This acquisition, immediately positions, HPE GreenLake in a high-growth data protection market with a proven scaled solution. HPE was the first to market four years ago in delivering another as-a-Service Cloud expedience on-premises, in a co-location or at the Edge with HPE GreenLake. Today, our HPE GreenLake edge-to-cloud platform, has more than 1,100 customers. Our annualized revenue run rate this quarter was $705 million, up 33% year-over-year, driven by strong as-a-Service orders growth, up 46% year-over-year.

Organizations across sectors, including retail, healthcare, financial services, and public sector, are turning to HPE GreenLake. For instance, we helped Liberty Mutual shift from a traditional CAPEX IT spend to a new pay-as-you-go model, creating a cloud experience on-premises to provide transparency into consumption while improving their speed in adapting to capacity demands. They standardized critical workloads on HPE Synergy, delivered through HPE GreenLake, resulting in a reduced data center footprint and significant cost savings, including a monthly unit rate well below public cloud alternatives.

We also see in the power of the full HPE edge-to-cloud portfolio as customers are turning to HPE for integrated solutions, a combined secure connectivity data insight capabilities, and cloud experiences. Woolworths Group, Australia and New Zealand's largest retailer selected HPE GreenLake to power its new W-pay payment platform. They needed a solution that combined a powerful mission-critical architecture, with the ability to scale and also provided better cost efficiency back to W-pay and its merchant partners. Delivered through HPE GreenLake, their solution leverages our full edge-to-cloud portfolio, including HP Aruba, HPE NonStop, HPE Primera, and HPE Synergy.

HPE Pointnext Services also provided expertise to us over the company's digital transformation. I believe this is a great example of the power of our HPE edge-to-cloud portfolio. To extend our leadership position in cloud services and further accelerate our pivot to as-a-Service, we are relentlessly innovating. We made several compelling announcements at HPE Discover in June. I am particularly excited about our new HPE GreenLake Lighthouse offering. A secure cloud-native stack built with HPE Ezmeral software to autonomously optimize different workloads across the hybrid state, reducing time to deployment, and operating costs.

We also introduced Project Aurora, to secure the enterprise. Embedded in our HPE GreenLake edge-to-cloud platform Project Aurora automatically, and continuously verifies an attack, the integrity of the hardware, freeware, operating systems, platforms, and workloads, while also detecting advanced threats. And finally, demonstrating our continued commitment to acquiring assets that complement our own capabilities, we acquired a data platform developer, Ampool. Ampool will accelerate the HP Ezmeral analytics run-time, to deliver high-performance analytics for engineers and business analysts.

I am proud of HP's performance in Q3 and year-to-date. And the significant progress we have made in becoming the edge-to-cloud company. The momentum we have in the market compels us to move even further and faster. And our ability to transform with increasing speed is imperative. This transformation is my number one priority. At this pivotal moment, our purpose to advance the way people live and work has never been more important. Our vision to become the edge-to-cloud company is proving its tremendous relevance. And our portfolio is winning in the marketplace. Fueled by our purpose, vision, and portfolio, we have the opportunity to build a more visibly-enabled inclusive world.

We have a mandate to imagine new digital transformation strategies that support our own ESG goals and those of our customers, leading to better business outcomes and societal impact. We will never waiver from our commitment to being a force for good, and a strategic partner for our customers. We will continue to bring both new innovations to our customers, and we will continue to create value for our shareholders, and I'm grateful for the incredible team and I'm confident in and excited about the future. I hope you will join us for our virtual security analyst meeting on October 28, to hear more about our position in the market, our priorities, and our outlook for the year ahead.

I will now turn it over to Tarek.

Tarek Robbiati
Thank you very much, Antonio. I'll start with a summary of our financial results for the third quarter of the fiscal year 2021. 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 on slides one and two. So now, let me discuss our Q3 performance starting with slide three.

I'm pleased to report that we are experiencing very strong demand across all of our businesses. Q3 was marked by accelerating order growth, strong gross and operating margin expansion, and robust cash flow generation. Building on the strength from the last quarter, we delivered Q3 revenues of $6.9 billion, up 3% from our prior quarter, and in line with normal sequential seasonality, also in line with our outlook that factored in some of the expected supply chain constraints we flagged. We are working to ensure disruption is minimal by taking proactive measures and coordinating with our world-class suppliers to establish tailored recovery plans.

I am particularly proud of our non-GAAP gross margin that hit another record level of 34.7%, up 40 basis points sequentially, and up 420 basis points from the prior-year period. This is driven by our deliberate actions to shift towards the higher-margin, software-rich offerings, strong pricing discipline, and cost takeout. As previously indicated, we continue to invest in high-growth, margin-rich areas of our portfolio, both in R&D and go-to-market, particularly in Aruba software and as-a-Service, which increased our non-GAAP operating expenses in the quarter.

We also booked two one-time charges totaling $28 million for a legal settlement and bad debt associated with likely fraud, involving a channel partner in APJ. Even with these investments and one-time charges, our non-GAAP operating margin was 9.8%, up 190 basis points from the prior year, which translates to a 25% year-over-year increase in operating profit. We continue to be focused on driving further efficiencies in the business.

Within other income and expenses, we benefited from stronger operational performance in H3C and strong gains related to increasing valuations in our Pathfinder venture portfolio. As a result, we now expect other income and expenses for fiscal year '21 to be an income of approximately $50 million. With strong execution across the business and despite two unanticipated one-time charges, we ended the quarter with non-GAAP EPS of $0.47, up 31% from the prior year and above the higher end of our outlook range for Q3. Q3 cash flow from operations was $1.1 billion and free cash flow was $526 million. This puts us at the record $1.5 billion of year-to-date free cash flow, up $1.1 billion from the prior year, driven primarily by an increase in operating profit.

Finally, the strength of our business has positioned us to contribute substantial capital to our shareholders. We paid $157 million of dividends in the quarter, and are declaring a Q4 dividend today of $0.12 per share payable in October. We are also announcing today the resumption of share buybacks as a result of greater free cash flow generation and visibility. I'll come back to capital allocation more broadly when we discuss the outlook.

Now let's turn to our segment highlights on slide four. Our growth businesses, which now represent nearly 25% of our total company revenue, are executing strongly and experiencing record order levels. In the Intelligent Edge, we accelerated our top line momentum with record levels of orders, and 23% year-over-year revenue growth. Switching was up over 20% year-over-year, whereas wireless LAN experienced more acute supply constraints and was up mid-single-digits.

Additionally, the Edge as-a-Service offerings were up triple-digits year-over-year, which reflects enabling software platforms, as well as network-as-a-Service. We also continue to see strong operating margins at 15.8% in Q3, up 540 basis points year-over-year, which included a $17 million one-time legal settlement that impacted margins by 2 points. Silver Peak continues to perform strongly and contributed seven points to the Intelligent Edge growth. In addition, we started generating meaningful revenue synergies by cross-selling the Aruba portfolio, which reinforces the merits of the Silver Peak deal.

In HPC & MCS, demand strengthened even further with a record order level. Revenue grew 9% year-over-year as we continue to achieve more customer accepting milestones and deliver on more than $2.5 billion of awarded contracts, including the contract that Antonio mentioned with the NSA worth $2 billion over 10 years. 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 4% quarter-over-quarter, reflecting normal sequential seasonality despite previously anticipated supply chain tightness. Operating margins of 11.2% were up 190 basis points from the prior year due to disciplined pricing and the right-sizing of the cost structure in this segment.

Within Storage, revenue grew 1% year-over-year and 3% quarter-over-quarter, ahead of normal sequential seasonality, driven by strong growth in software-defined offerings. Nimble grew 10% year-over-year, with ongoing strong dHCI momentum, growing double-digits year-over-year. All-flash arrays grew by over 30% year-over-year, led by Primera. The mix shift towards more software-rich platforms helped drive Storage operating margins to 15.1%, up 10 basis points year-over-year, offset by continued investments in our cloud data services.

With respect to Pointnext operational services, including Nimble services, revenue grew for the third consecutive quarter year-over-year as reported, with both order and revenue growth expected for fiscal year '21.

Within HPE Financial Services, revenue was flat year-over-year and sequentially. While our bad debt loss ratio did increase slightly to 94 basis points this quarter, it was entirely due to a one-time $11 million reserve charge related to the already mentioned likely fraud in APJ by a channel partner. Absent this one-off event, our bad debt loss ratio would have improved to just 61 basis points, aligned to pre-pandemic levels.

More importantly, we continue to see improved cash collections above pre-pandemic levels. Our operating margin was 11.1%, up 300 basis points from the prior year and our return on equity at 18.3% is well above the 15% plus target set at SAM.

Slide five highlights the key metrics of our growing as-a-Service business. We have made significant progress since our Analyst Day last October by adding over 200 new enterprise GreenLake customers to over 1,100 today, and increasing our TCV by over $1 billion to our current lifetime TCV of well over $5 billion.

For Q3 specifically, our ARR was $705 million, which was up 33% year-over-year as reported and total as-a-Service orders were up 46% year-over-year. It is also important to note that the mix of our ARR is becoming more and more software-rich as we build out our GreenLake Cloud platform, which is improving our margin profile. We look forward to providing more disclosure around our software and services mix at our Analyst Day later this fall, which I believe reinforces a significant value-add of GreenLake. Overall, 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 target of 30% to 40% CAGR from FY '20 to FY '23.

Slide six highlights our revenue and EPS performance to date, where you can clearly see the strong rebound from last year and sustained momentum for the last three quarters. The demand environment continues to strengthen. And with the operational execution of our cost optimization and resource allocation program, we have increased non-GAAP EPS in Q3 by 31% year-over-year.

Turning to slide seven, we delivered another record non-GAAP gross margin rate in Q3 of 34.7% of revenues, which was up 40 basis points sequentially and up 420 basis points on the prior year. This was driven by strong pricing discipline 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 our new segmentation we implemented beginning of fiscal year 2020, that gives us much better visibility into each business unit and enables the better resource allocation and discipline to drive operating leverage.

Moving to slide eight, you can also see we have expanded non-GAAP operating profit margins substantially from pandemic lows to 9.8%, which is up 190 basis points from the prior year period. We are 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. As mentioned previously, Q3 operating expenses also included one-time charges not included in our guidance, totaling $28 million for a legal settlement and the likely fraud scheme involving a partner. Excluding these one-off charges, our operating margin would have been 10.2%.

Turning to slide nine, we generated a record year-to-date levels of cash flow with $2.9 billion of cash flow from operations and $1.5 billion of free cash flow, which is up $1.1 billion year-over-year. This was primarily driven by increased operating profit. I would like also to underscore that this year, our free cash flow seasonality will be different than in prior years. We expect increased financial services volume that include more than $150 million in Q4 financing for a very large deal that is predominantly GreenLake and will benefit our ARR and margins for years to come. We also have further restructuring payments and growing working capital needs, as we continue to buffer our inventory levels in the light of the disruption in the global IT supply chain.

Now moving on to slide 10, let me remind everyone about the strength of our diversified balance sheet. As of July 31st, the operating company net cash balance turned positive due to our strong free cash flow. Furthermore, we made additional progress during the quarter, securitizing over $750 million of financial services related debt through the ABS market. The refinancing of higher cost unsecured debt with ABS financing allows us to boost access to financing market at a cheaper cost of debt capital, as well as diversify and segregate our balance sheet between our operating company and our financial services business. Bottom line, our improved free cash flow outlook and cash position ensure we have ample liquidity to run operations, continuing to invest in our business to drive growth and return capital to shareholders.

Now turning to our outlook on slide 11. I'm 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 execution. This will be the fourth guidance increase since SAM in October 2020. We now expect to deliver fiscal year '21 non-GAAP diluted net earnings per share between $1.88 and $1.96.

With respect to supply chain, as indicated last quarter, industry-wide tightening somewhat constrained our supply as expected. We continue to take proactive inventory measures where possible and you can see our efforts in inventory balances that increased $1.3 billion year-to-date that also reflects the strengthening demand environment and a substantial order book we have across the business. We expect the challenged supply chain conditions to persist until at least the middle of calendar year 2022 and have factored these into our revenues, costs and cash flow outlook.

From a top-line perspective, although we remain prudent given the challenged supply chain environment, we are very pleased with the accelerating Q3 order momentum across all segments of the business. More specifically for Q4 '21, we expect revenue to be above our normal sequential seasonality from Q3 and are comfortable with current consensus levels.

For Q4 '21, we expect GAAP diluted net EPS of $0.14 to $0.22, and non-GAAP diluted net EPS of $0.44 to $0.52.

Additionally, given our record levels of free cash flow year-to-date and confidence in our raised outlook, I am very pleased to announce that we are also raising fiscal year ’21 free cash flow guidance to $1.5 billion to $1.7 billion, that is a $600 million increase at the midpoint from our original SAM guidance, with the top end of this free cash flow guidance range at the peak levels attained in fiscal year ’19.

As you recall, at the end of the first half of fiscal year 2020, we suspended our share buybacks to preserve liquidity in the context of the global pandemic disruption. Although we continue to operate in a challenged supply environment, our order momentum and improved cash flow generation visibility give us confidence to reinstate our share repurchase program. We are targeting up to $250 million of share repurchases in Q4 of fiscal year ’21 and we’ll update investors on our capital management policy for fiscal year ’22 at SAM in October.

As a reminder, we always follow a disciplined return-based capital allocation framework to maximize long-term shareholder value. Our number one priority remains delivering sustainable profitable growth through both organic and inorganic M&A investments while remaining committed to paying dividends to our shareholders. In addition, we will consider opportunistic share buybacks when we see a favorable return for doing so.

So overall, and to conclude, I am very proud of the progress we have made year-to-date in fiscal year '21. It's clear that our edge-to-cloud strategy is resonating with customers, and driving improved momentum across all of our businesses.

Our growth businesses in the Intelligent Edge and HPC & MCS have accelerated top-line performance with record levels of orders. Our core business of Compute and Storage is demonstrating momentum with robust orders and improved margins, and our as-a-Service ARR is accelerating.

All of this translates to improving revenue momentum, strong profitability growth, and record levels of free cash flow. We look forward to closing out our fiscal year much leaner, better resourced and positioned to capitalize on the strong demand environment.

Lastly, as Antonio mentioned, we look forward to having you join us for our Virtual Securities Analyst Meeting in late October, where we will provide an update on our strategy, business insights, and financial outlook.

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

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 will come from Amit Daryanani with Evercore. Please, go ahead.

Amit Daryanani
Good afternoon, and thanks for taking my question. I guess, the questions really around the free cash flow generation. I think, you are implying based on the raised free cash flow guide,

that we'll do around 100 million or so free cash flow in Q4, that I think will be one of the softer Q4s we've seen. So, maybe just to quantify some of the dynamics that are at play that's driving that power, have you talked about a few of them, but just quantify the headwind there. And then secondly, the focus that you folks have always been getting to this $2 billion in cash flow number longer-term. Maybe touch on what are the key levers to get to the $2 billion number, and how much of that is self help versus revenue driven? Thank you.

Tarek Robbiati
Sure. Thank you, Amit for the question. So, yes, our free cash flow for Q4 is north of $100 million, it's actually implied in our guidance about $150 million in Q4. And this figure reflects a different seasonal profile that we have had this year in terms of our revenue and expense profile, but also a couple of very important dynamics that I would like to underscore.

First of all, we have to continue to make investments in our inventory level to withstand the supply chain constraints that we flagged for several quarters now. Second, in Q4 of fiscal year '21, in my script, I described a very, very large GreenLake deal that will impact free cash flow in Q4, but that will generate substantial ARR revenue in subsequent quarters.

This is a deal in several 100 millions of dollars, that we have not announced yet, but it is already something that we're financing. And this is affecting therefore free cash flow already as of Q4 of fiscal year '21.

Thirdly, we are still peaking on restructuring costs in fiscal year '21 and we feel very positive about our cost optimization and resource allocation program, which will wind down at the end of fiscal year '22. And so, this is a nice segue to tell you about our guidance towards fiscal year '22 and the $2 billion target that we have. We continue to expect revenue growth in fiscal year '22 with the momentum that carries out of fiscal year '21, and also the restructuring cost program winding down will be a key determinant of our generation of free cash flow in fiscal year '22. So hopefully I gave you color there.

Antonio, want to add something?

Antonio Neri
No, the only thing I will say is that listen, Tarek made this comment in his remarks, is the fact of the matter on the high-end, on the top end of that guidance we give you $1.7 billion, is almost the same number we achieved in 2019. And therefore, in many ways, we are almost a year ahead of our commitment, because if you recall, we said we're going to return to normalized free cash flow in 2022. In reality, even when you finance these large deals that eventually we're going to communicate has nothing to do with the NSA deal. We are already almost at the same number. So that's why we are so pleased with the momentum that we have.

But it's a momentum based on the order growth, and all the actions we have taken, and the deliberate shift in our portfolio to higher margins. And that's what you see in our numbers in Q3, right, it's a record-breaking gross margin of 34.7%.

Andrew Simanek
Perfect, thanks Amit for the question. Operator, can we go to the next one?

Operator
The next question will come from Simon Leopold with Raymond James. Please go ahead.

Simon Leopold
Thank you for taking the question. I wanted to see if you could discuss what you've done and what you plan to do in regards to price increases and help us understand how this affects your sales growth and margins? Thank you.

Antonio Neri
Yes, thanks, Simon, for the question. I will start, and then I will let Tarek comment. Listen, we take pricing actions all the time. In fact, we probably have the first to take pricing action in our industry, I will say. We continue to assess what is the right strategy by segment and making sure that we take those actions where appropriate.

And you know, the fact that the matter is that we have increased pricing even in Q2, that's a fact. And we do that in a context of, obviously, supply availability, steep in demand in the right portfolio, and obviously, inflationary costs associated with some of the commodities. At the same time, remember there is also new innovation against building our products, which have structural impact in the sense that when you look at our infrastructure, new technologies drive two-thirds of the pricing in many ways in AUPs, but we could take those the actions all the time, Simon, and we will continue to do so.

And that's part of the reason also while we see record-breaking margins but in addition to the fact that we're still in the demand in the right place and driving that mix shift that we talked about before. So, Tarek, I know you want to get more specific, probably.

Tarek Robbiati
Thank you, Antonio, and thank you, Simon, for the question. We have in this context where you have a constrained supply environment to be very careful around managing pricing. And we have taken action that is translating in this record level of gross margin of 34.7%. Some of our competitors didn't take that action and it's down to them and up to them. But we feel that the current environment is calling for additional actions approach to pricing. And we see an encouraged, balanced pricing behavior across the market.

So more specifically, with respect to our units and AUPs in Compute, that become…I'm sure someone will ask the question. AUP was up to mid to high single-digits quarter-on-quarter reflecting pass-through of commodity costs and richer configurations. As always, configurations that are richer play a big role in the AUP, but also, pricing in this case. And units were flat quarter-over-quarter, given some expected supply chain constraints. So, we feel pretty good about performance in computing. In that regard, it's still a business that we have to manage very, very carefully on a day-to-day basis, because the supply environment being volatile forces us to do so. But we still see scope for continuous gross margin improvement across the board and in Compute as well.

Andrew Simanek
Perfect, thanks for the question, Simon. Operator, can we go to the next one?

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

Aaron Rakers
Yes. Thanks for taking the question. I'm going to ask for one clarification real quick. Just, how would you define normal seasonality in fiscal 4Q? And then kind of the longer-term question would be, Tarek you've done a phenomenal job of driving gross margin leverage in the

company. I'd just love to hear your thoughts on, as you think about the mix of business going forward, where do you think ultimately gross margin can actually go. What's the normalized gross margin in your mind, given the mix that HP's driving?

Tarek Robbiati
So, let me pick up the first question on the normalized seasonality. Typically, what you observe in terms of sequential quarter-over-quarter growth, I would say it's somewhere in the low single-digits around the 1% to 2% range between Q3 and Q4, so Q4 and Q3 growth is about that level. Like I said in my script, I'm comfortable with the current consensus on revenue for Q4, and we feel pretty good about this

The order book is very, very solid. Antonio underscored this, across the board, our order book is super solid. Now the question is, how much of that can be really accelerated in terms of conversion in Q4? And it's, every day is another day. So, we're working through that. And this obviously has an impact on gross margins, right, because the more you wait for fulfilling an order, the more you can have an adverse impact on gross margins. But we feel fairly comfortable with us managing this dynamic and particularly leveraging or pulling the levers across the board that we have such as our revenue mix.

I want to highlight to you the continuous growth in Aruba. This level of growth in Aruba on our Intelligent Edge business of 23% comes with very high-calorie revenue, and we feel very, very comfortable and pleased with that trend. Also, our growth in Storage, which comes with very high-calorie gross margin revenue, is pleasing at 3%. We took share from some of our main competitors, and this gives you an idea that we have a few strings in our bow, so to speak, to actually continue to drive gross margins to better levels.

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

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

Wamsi Mohan
Yes. Thank you. You sound very bullish on order momentum, and it seems like you can't capitalize on the full strong demand given some of the supply chain impacts. Is there any way to quantify the magnitude of sort of what is this revenue impact perhaps in the quarter and what you're expecting for maybe the next few quarters, and how confident are you that these orders won't be canceled or lost to other vendors? Thank you.

Antonio Neri
Well, we are very confident in the sense that we have taken proactive actions…we continue to take proactive actions that can imagine a person evolve with some of this conversation with suppliers. But if you look at our order buffering, inventory buffering we talked, our inventory is up 1.3 billion. And at the same time, right, we have, I think, one of the best-in-class engineering teams that they can swap things as we go along the way.

That said, as a look at this order book, there is so much potential upside here. It’s all about the daily conversion. And so far, Wamsi, we have not seen any cancellations. Just to be clear, when people ask me, hey, this is perishable? No, I can tell you, the answer is definitely, no. I think it's because also customers realize it's not just a supply constraint, but a need to provision more Compute and data insight capabilities. And then, as I said earlier, even despite the fact that our Intelligent Edge business exited with a 5 times backlog on that unique segment of the market, we still delivered 23% in constant currency, 27% growth. And that's why what Tarek said, we expect revenue to continue to grow, and in particular '22.

And then to the question that was asked earlier about margin, the margin should strengthen over time, because of the mix shift, and that Aruba is very important to us. But fundamentally, I think our edge-to-cloud vision and strategy is absolutely resonating in the market, because customers need three things. They need secured connectivity in this hybrid world. They need a cloud experience everywhere. And they need data insights yesterday, in my view. And then, we need to be able to consume it as-a-Service in an elastic way. We have all the four ingredients, and that's why we're going to accelerate further and faster with this strategy because it's working.

Tarek Robbiati
And Wamsi, if I can add to Antonio's comments. In my mind, there is no point crying over spilled milk. If we could have converted more, we would have converted more, but it doesn't really matter. The order momentum and the order book remained strong. And what we didn't convert in Q3 will convert in Q4 and subsequent quarters. To specifically give you an idea of where we would have ended in Q3. We probably would have ended above seasonal trends that we see between Q2 and Q3 by a low single-digit percentage number. But the momentum is very strong in Q4 and also for '22, that's the interesting bit. In the environment that we're operating in, the demand is very solid and the supply constraints, we don't see them ending before the first half of calendar year '22. So, we just have to navigate this as the capacity of all our manufacturing partners is not back to pre-pandemic levels, and that will still take a good two to three quarters.

Andrew Simanek
Great. Thank you, Wamsi for the question. Operator, can we go to the next one, please?

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

Sidney Ho
Great, and congrats on solid progress on the ARR side and in the cash flow. My question is on the HPC segment. You suggested the full-year HPC revenue will grow within the target range of 8% to 12%. Is that on a revenue basis or order basis? And in this revenue, it would imply fiscal Q2 will see at least 50% growth. Am I doing the math correctly? If so, what's driving such growth, I understand revenue could be quite lumpy in this business. Thanks.

Antonio Neri
Yes, let me start, and Tarek is welcome to add. Listen, as you said, this business is lumpy because of the time it takes to book the order, to build it, to ship it and install it. And then most importantly customer accept the order, meaning the workload that was intended to run on is active…is in production. And we normally see this trend accelerate in the back half of the year because of the way the acceptances work. So, we absolutely expect a significant uptick here.

And that's why we are very confident in our ability to deliver for the year 2021 the 8% to 12% growth that we committed. Since the beginning actually 2021. And we have a number of deals that are all now running what we call the testing cycles. And fairly confident about the customer acceptances, which would allow us to recognize revenue. This has nothing to do with supply availability in many ways because, obviously, those systems, in many ways, has already shipped and they're already deployed. It just getting through the cycle for the customer to get the performance that they need. And there is quite a bit of tuning that does get done when the systems are deployed.

But to Tarek's point, the demand is unbelievably strong. Put aside the $2 billion award that we announced yesterday, we continue to win multiple multimillion dollar deals in many aspects. And you can see some of those as we announced throughout the quarter. And that's the power of the portfolio we have in high performance computing, and specifically, tuned for this AI and deep learning capabilities. And by the way, we have $2.5 billion of award the business, which I don't consider backlog, is business that will be delivered over the next 12, 18 months. In particular, the large Exascale systems, which are an amazing feat of technology, I will say.

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

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

Shannon Cross
Thank you very much. I was wondering if you can quantify how the shift to GreenLake and recurring revenue in as-a-service is impacting revenue. If there's any way to sort of quantify where you would have been if you hadn't sort of made the shift at this point. And I'm also curious with regard to GreenLake, how are your customer conversations going, not sure how many quarters ago you said we're shifting everything to at least have an option as from a subscription standpoint. So, I'm just wondering if it's still kind of a push to customers or is there more of a pull from them as they look at alternatives to the cloud? Thank you.

Antonio Neri
Well, thank you, Shannon. I mean, we are incredibly bullish about this business. I think we have a competitive advantage, and the competitive advantage come from many aspects. One is the software. Software that makes this consumption model a true consumption model, unlike some of the other ones we are trying to catch up, which is more financial engineering in many ways. Understand everybody's getting into the space, but we have years of leadership here. And the conversation goes as simple as this. I want the cloud experience on-premise and at the Edge. And we can bring that through GreenLake, because it's a true cloud experience that you can consume elastically on a per-unit measure that we can measure all the way to core levels. And be able to automate the whole experience through our software stack, which obviously HPE Ezmeral model now, is becoming a very important component of that. And that's why Tarek made the comment earlier. As we go through to SAM at the end of October, we are going to give a little better disclosure of that because the software content with ARR continues to increase.

Aruba by definition Shannon, is really all software. And he said that triple-digit growth is happening in our business because you are subscribing to get connectivity. And our platform is a cloud platform that scales because we manage now more than 1.5 million devices. But it's more than pull, I would say, when customers are becoming way more sophisticated about the hybrid state, where they should host the data, they realize that the vast majority is still on-premise. And many of them will stay on-premise. It's just economics and physics, and we can deliver some experience on-prem and still give them a hybrid experience by managing the workloads and data that sit outside the four walls. And GreenLake is absolutely resonating and that's why you see us catering everything to GreenLake, whether it's connectivity, whether its data services, whether it is elastic computing and more workload optimized services as we go along. And that's why I said earlier, this is all about acceleration on that. And between now and March, you're going to see a massive acceleration. And that's why it's my number one priority. And by the way, as revenue is accretive from a gross margin perspective, so, Tarek, you want to talk about that.

Tarek Robbiati
Yes, absolutely. So, Shannon, what I would say is, if you refer back to slide five of our investor presentation, we show you the stack of revenue that composes our ARR. So, our GreenLake revenue is across all segments, our Compute, HPC, MCS, Storage, Aruba, and also HPFS as you can infer from that slide. And the more we drive GreenLake by way of software, the more accretive it is to the overall gross margin of the company.

That's a key lever to drive gross margin moving forward. We're driving gross margin across every single stream lane through the revenue mix, and across also that revenue mix horizontally by way of pivoting the company to become an as-a-Service company. So far, what I can tell you is that the GreenLake gross margin is substantially higher than the average gross margin of the company that we posted today. And we look forward, Antonio and I, to update you and every other member of the analyst's community at our virtual SAM event in October highlighting to you where we see the ARR growing. And it's mixed by segment moving forward. And in composition, how much of it is software and how much of it comes from other types of revenue streams such as Pointnext OS, which are very important to the profitability of the company.

Andrew Simanek
Great. Thanks, Shannon. Next question, please, Operator.

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

Katy Huberty
Yes. Thank you. Speaking of GreenLake, the $2 billion NSA contract is a great success story for that business. Should we assume that the $2 billion of revenue is recognized ratably over the 10 year contracts or will there still be lumpiness like you've seen in HPC historically. And then also, when does that start to impact the financial model? Then I have a follow-up.

Antonio Neri
Yes, I think it will be definitely recognized over time. There will be periods that will be a little bit lumpier, because of the infrastructure, but they start recognizing here in 2022 immediately. In fact, we're expecting here the first order happening now, and start shipping soon. But obviously, the one thing you need to understand about this deal, it's not just about selling infrastructure and consumer as-a-Service through HPE GreenLake, it's a true as-a-Service model and management at the same time. So, we are operating the whole environment, which is very different than it used to be in the past.

Andrew Simanek
Thanks, Katy. I know you had a follow-up, but we'll catch you after the call. Operator, can we go to the next question, please?

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

Pardon me, Mr. Sheerin, your line might be muted.

Andrew Simanek
No problem. Operator, can we just go ahead to the next one?

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

Kyle McNealy
Hi, thanks a lot for the question. Congrats on the strong results in Intelligent Edge. But I'm curious on where you think we can go from here. It's been growing at faster than what the market's typically grown at in the past. We realize that Wi-Fi 6 adoption curve is helping that, but how sustainable do you think this 20% plus growth rate is that we're seeing now, and should we expect some deceleration in there, or is there potential for continuing momentum or acceleration with the Wi-Fi 6 upgrade?

Antonio Neri
Listen, I expect this business to continue to grow double-digits. And we're very confident with that forecast. And honestly, maintaining or improve it even, the level of profitability because as Tarek made the comment earlier, this quarter was impacted by a settlement on a legal matter that has been going on for a decade. And so, I'm pleased that that finally has completed, which was $17 million that we booked for this and has nothing to do with Aruba. It just happened way before Aruba for that matter. And so, the reason why I'm confident is because we have a unique value proposition.

The value proposition of Aruba is mobile-first, cloud-first, which is based on three layers. One is the unification of the network for whatever type of connectivity you need, which is Wi-Fi and to the point, Wi-Fi 6 is now been adopted, and we are, I think, the largest vendor shipping Wi-Fi access points. Second is obviously LAN. Third is WAN, and that's why this acquisition of Silver Peak has been incredibly well-received by our customers and very timely because it's integrated now in the same control plane.

And going forward, we're going to integrate more solutions like 5G and Edge computing, and that's why this edge-to-cloud platform is so essential. But the Aruba Edge platform is what allows us to deliver the entire edge-to-cloud platform, because now that platform also serves as the backend to deliver IaaS for for customer’s on-prem and at the edge for Compute and Storage, too, including data services or workload optimized solutions. So super pleased, and remember what I said, we exit Q3 2021 with a five times backlog on a normal run rate in Aruba, and the bookings were very, very strong, super strong.

Andrew Simanek
Great. Thanks, Kyle, for the question. And I think that takes us about time. So that'll be our final question. Antonio, why don't I turn it over to you for any final remarks if you have?

CONCLUSION

Antonio Neri
Yes. So again, thank you for making the time today. Again, we are very pleased with our Q3 result, which again was marked by the order strong momentum in line with revenue expectations, but most importantly, strong improvement in gross and operating margin, and record year-to-date orders and free cash flow. And that gives us the confidence to, once again,

for the fourth time in the year to raise EPS and free cash flow and enter 2022 with good visibility about what we think is going to happen. I'm particularly bullish about the IT spend cycle. People ask me, what do you think the Delta virus is going to do? It is going to do nothing on demand. I can tell you that now. It may have some impact on supply availability, but nothing on-demand, let me be clear about that. And the reason why is because customers need to digitize their business, they need to create a more IT driven environment, and honestly, they need to extract insight from the data at the pace we've never seen before, and our edge-to-cloud platform strategy is resonating.

So, thank you for making the time to be with us today and hope to catch up at the end of October at the Securities Analyst Meeting.

Andrew Simanek
Perfect. Thank you. Operator, I think we can go ahead and close up the call.

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