Hewlett Packard Enterprise

Third Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Meg Whitman - *Chief Executive Officer*

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

Andy Simanek - *Head of Investor Relations*

PRESENTATION

Operator
Good morning, afternoon, and evening, and welcome to the Third Quarter 2017 Hewlett Packard Enterprise Earnings Conference Call. My name is Austin, and I'll be your conference moderator for today's call. At this time, all participants will be in listen-only mode. We will be facilitating a question and answer session towards the end of the conference. Should you need any instance 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. Andy Simanek, Head of Investor Relations. Please proceed.

Andy Simanek
Good afternoon. I am Andy Simanek, Head of Investor Relations for Hewlett Packard Enterprise. I'd like to welcome you to our fiscal 2017 third quarter earnings conference call with Meg Whitman, HPE's Chief Executive Officer, and Tim Stonesifer, HPE's Executive Vice President and Chief Financial Officer.

Before handing the call over to Meg, 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, 2017.

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. Throughout this conference call all revenue growth rates, unless noted otherwise, are presented on a year-over-year basis and beginning with fiscal year 2016 are adjusted to exclude the impact of divestitures and currency. We believe this approach helps provide a better representation of HPE's operational performance. Please refer to the tables and slide presentation accompanying today's earnings release on our website for details.

With that, let me turn it over to Meg.

Meg Whitman
Good afternoon, everyone. Thank you for joining us on the call.

Today, I would like to cover a couple of things. First, I'll review the results for the quarter. Then, I'd like to talk about what we see ahead, how we are redesigning this company to be fit for purpose, and how we are driving the innovation needed to win in the market.

So let's dive right in.

Overall, I am very pleased with our Q3 performance. We saw strong momentum across key segments of the portfolio. Execution continued to improve and our profitability increased over last quarter as we reduced costs across the organization. And, we successfully closed the spin-merge of our software business late last week. With that milestone behind us, we are off and running.

In Q3, we delivered total revenue of $8.2 billion, which includes a final full quarter of revenue contribution from Software.

Future HPE, which now consists of Enterprise Group and Financial Services, was $7.5 billion, up 6% year over year. And, if you remove tier-1, revenue was up 10%.

From a profitability perspective, we made good progress on improving our operating margins as we began executing the cost reduction plan we outlined last quarter. Tim will provide more detail, but our EG margin improved sequentially to 9.3% as we worked to mitigate increased commodity prices, stranded costs from divestitures and dilution from acquisitions. We expect to see even greater improvement next quarter.

With the strong revenue performance and improved profitability, we were able to deliver non-GAAP EPS of $0.30, above our previously provided outlook of $0.24 to $0.28 per share.

Free cash flow was also strong at over $400 million in the quarter, putting us in a good position to achieve our full year outlook.

Turning to the business performance…

While we have seen some improvement in the market overall, our strong Q3 performance was driven primarily by better execution and a compelling portfolio, resulting in solid growth across key businesses.

For example, core server revenue was up 13% year over year and we expect to gain share in calendar Q2. Since its launch late last year, Synergy is experiencing very strong momentum, with over 600 customers to date. As a side benefit, we are also seeing an uptick in blade sales as customers move onto the path to become Synergy ready. We are also experiencing continued strength in high performance compute with our combined HPE and SGI portfolio. And, early this summer we launched the first fully integrated HPE SimpliVity hyperconverged offering. Hyperconverged is core to our strategy of making Hybrid IT simple for our customers, and we saw over 200% growth in Q3, although off a small base.

All Flash storage grew 30% year over year driven by Nimble, which exceeded both revenue and profit plans for the quarter. With Nimble and our market-leading 3PAR portfolio, HPE delivers a full range of superior flash storage solutions for customers across every segment. We are already seeing the benefits of the combination of Nimble and HPE, and we couldn't be more excited about the potential.

Aruba continues to perform exceptionally well. Wireless LAN solutions grew over 30% in the quarter and Aruba won approximately 70 new logos. Aruba continues to take share from competitors like Cisco by introducing truly breakthrough solutions for the intelligent edge. For example, in June, Aruba announced a fundamentally new core aggregation switch, called Aruba 8400. This differentiated solution has a completely redesigned operating system to support the new requirements of modern networks. It enables simplified operations for the network operator, a more powerful and scalable core to support the influx of data, faster time to remediate issues, and granular visibility into what's in the network. We estimate the market for this technology is nearly $4 billion.

And, Technology Services, which includes Pointnext, continued to perform well, with Q3 revenue up 2% over last year. We've now seen five consecutive quarters of order and revenue growth in consulting as we've put more emphasis on advisory and transform services post the ES split.

To further strengthen our consulting capabilities, just this morning we announced our intent to acquire Cloud Technology Partners, a leading cloud consulting company that helps its Fortune 500 customers move to the cloud, build new cloud-based solutions and manage their cloud environment. CTP's consulting, design and operational advisory services for cloud environments will strengthen our Hybrid IT consulting expertise in a fast growing market.

As I mentioned earlier, while executing our business plan for the quarter, we also completed a major milestone. On Friday we officially closed the spin off and merger of our Software business with Micro Focus, on time and below budget. This deal delivered approximately $9 billion in value and I am confident that this was a great move for the new Micro Focus and for HPE.

With that transaction now behind us, we have the right strategy, and the right portfolio, to succeed in today's environment. Our strategy is clear – to make Hybrid IT simple, to power the intelligent edge and to provide the services to make it all happen. It is based on what our customers are asking for today and where we see the market moving.

Now, as a smaller organization, with fewer lines of business and clear strategic priorities, we have the opportunity to create an internal structure and operating model that is simpler, nimbler and faster. To that end, this quarter we announced a program we are calling HPE Next.

The goal of HPE Next is to produce an organization that is precisely built to compete and win in the marketplace.

To do so, we are clean-sheeting the operating model and organizational structure to simplify how we work. We are improving core business processes to clarify accountabilities and make the company more efficient and effective. We are right-sizing the end-to-end cost structure to ensure we deliver on our financial architecture. All of this will be done with a continued commitment to operational excellence and to our customers.

These efforts will simplify everything from how we engage with customers to how we process orders and compensate sales. For example, we are reducing the layers in our customer-facing organizations and shifting resources to the geographic markets that drive the vast majority of our business. These changes will be better for HPE and for our customers.

We will have much more detail on this program and the associated financial impact at our Securities Analyst Meeting in October. But, as discussed on previous calls, we do expect to accelerate most of the $200 million of cash payments originally planned for fiscal year 2018 into Q4 2017 to help quickly enable this program.

Looking forward, we aim to offset a portion of the funding requirements associated with HPE Next through lower than expected separation costs and real estate sales enabled by the spin-merge transactions completed this year. For example, we recently sold our Roseville site for approximately $100 million and are now leasing back smaller offices there.

Ultimately, HPE Next will produce the long-term operating and financial blueprint for our company, with cost discipline built into the system.

While we work to create this strong internal structure we cannot lose sight of innovation. Innovation is our life blood and the investments we make now will drive HPE in the future.

Our innovation is at the core of some of the most significant technology trends in the market today, like cyber security, internet of things and artificial intelligence. And, today more than ever, we are able to make focused investments in the areas where we see the most opportunity for growth in the future.

For example, security has become a board level issue for customers across industries and market segments. In June, we announced the world's most secure industry standard server. HPE is the only company that embeds proprietary silicon-based security into its industry standard servers. This approach addresses firmware attacks, which are one of the biggest threats facing enterprises and governments today. We are also integrating the behavioral analytics based security software from our recent acquisition, Niara, across Aruba's networking portfolio.

In the internet of things, and in particular the industrial internet of things, we see a tremendous opportunity as customers are looking to transform everything from retail environments to manufacturing floors. Our solutions and services capabilities are allowing customers to connect, monitor and analyze these environments and enable new customer experiences, new revenue streams and reduced cost structures. We are already seeing growth in our Aruba wireless connectivity business driven by IoT, and we are seeing significant emerging interest in our highly differentiated edge compute business known as Edgeline driven by these same trends.

Another example is Artificial Intelligence, which is transforming industries from retail to manufacturing. We help our customers use AI to simplify operations and drive business outcomes in a number of ways. For example, we are incorporating Nimble's predictive analytics technology that uses machine learning to predict and resolve performance issues, across our storage portfolio. Also, our high performance compute systems provide the power that is required to crunch the massive amount of data used for AI applications. As the amount of data grows, we have a strong roadmap to memory driven computing, based on our Machine research project, that will exponentially extend these capabilities in the future.

Finally, if there's one commonality our customers have, it's that they live in a hybrid IT world. They run a mix of workloads in the data center, as well as private, managed and public clouds. Our top priority is to help them succeed in this environment – and that requires a single data management plane across a different environments.

At Discover, we unveiled our vision for our new Hybrid IT stack, which brings together our industry leading OneView platform with a new multi-cloud management capability, as well as key software assets like Cloud Cruiser, to create a truly unique software-defined approach to hybrid IT management. This new platform will allow customers to simply manage assets across traditional IT, private cloud, managed and public clouds, and optimize their right mix of hybrid IT. We already have a number of beta customers and this platform will be widely available by the end of the year.

So, overall, I'm very pleased with the quarter. And, we have now achieved most of our significant milestones for the year. While we have more work to do, I continue to be excited about the future of HPE. The markets where we play today offer tremendous opportunity and with laser focus and a world-class portfolio, we are positioned to win.

We'll have a lot more to tell you at our Securities Analyst Meeting on October 18th in San Francisco.

Before I turn it over to Tim, I want to quickly touch on the devastation we are all seeing in Texas caused by Hurricane Harvey. HPE has been part of the Houston community for decades, and our nearly 3400 employees are deeply rooted in the community. The well-being of our employees and their families has been our top concern over the past week and we are providing support to many of them. From a business perspective, we're continuing to assess the impact, but Tim will provide a bit more color on that.

I want to thank our amazing team in Houston, who has been working around the clock to get our office back up and running, answer customer inquiries and make sure their colleagues have the support they need. Thank you.

And with that, I'll turn it over to Tim.

Tim Stonesifer

Thanks Meg.

Performance in Q3 was strong with solid revenue growth and sequential operating margin improvement, in-line with our expectations. We achieved better than expected cost savings from the plan we described last quarter with more improvement expected to come next quarter.

Total revenue for the quarter was $8.2B. This includes a full quarter of Software, which going forward will be accounted for in discontinued operations. Revenue from Future HPE was $7.5B, up 6% adjusted for divestitures and currency, and up over 10% excluding Tier-1 server sales. I'll dive into the business segment performance in a minute.

From a macro perspective we are seeing some overall improvement in the market but continue to see competitive pricing and a challenging commodities environment. Currency remained unfavorable, but to a lesser extent than prior quarters, with a 70 basis point year over year headwind to revenue in Q3. HPE's performance in the US, excluding Tier 1 improved, as core servers returned to growth and networking performance accelerated but storage remained challenged. Revenue in Europe also returned to growth, with strong results in Germany and broad stabilization across Western Europe. Asia Pacific similarly improved with double digit growth in Japan, China, and India.

Turning to margins, gross margin of 33.0% was down 340 bps year over year and down 80 bps sequentially. Non-GAAP operating profit of 8.4% was down 150 bps year over year but up 60 bps sequentially. As mentioned, we are seeing the initial results of our second half cost savings plan, with sequential improvement in EG margins. However, we continue to be negatively impacted by a challenging pricing environment, commodities costs, and to a lesser extent currency. We also had a full quarter impact from stranded costs and short-term dilution from recent acquisitions, but are making good progress and still expect both to be eliminated by year end.

Non-GAAP diluted net earnings per share of $0.30, is above our previous outlook of $0.24-0.28, primarily due to cost savings, Software performance, and favorable other income & expense. Non-GAAP diluted net earnings per share primarily excludes pre-tax amounts for separation charges of $190M, restructuring charges of $165M, and amortization of intangible assets of $132M.

GAAP diluted net earnings per was $0.10, above our previously provided outlook range of ($0.02) to $0.02, primarily due to an Enterprise Services spin-merger related, non-cash income tax benefit.

Now turning to the results by business…

In the Enterprise Group, revenue was up 3% as the go-to-market changes we made at the beginning of the year, combined with recent product rollouts, more than offset pressure from a competitive market. EG revenue grew over 9% year over year excluding Tier 1 server sales, with strong growth in ISS core, Aruba, and all-flash storage.

Operating margins were down 350bps year over year, however they improved 50 bps sequentially to 9.3%. The sequential margin improvement is in-line with the cost savings plan we outlined on the Q2 earnings call, which called for savings of $200-300M in the second half of the year.

Server revenue was flat, and grew 12% excluding Tier 1 thanks to better execution, easier compares from the prior year and some improvement in the overall market. We also have a strong portfolio in the growing and more profitable areas of the market. High Performance Compute grew more than 40% with SGI, and over 10% organically. And Synergy's momentum is generating strong pull-through for Blades that were up double-digits. We're also seeing good traction in hyper-converged that grew triple-digits.

Storage revenue was up 11% driven by the Nimble acquisition, offset by continued challenging markets. All-flash arrays grew 30% year-over-year primarily driven by the Nimble acquisition, which is performing ahead of expectations. We continue to expect NAND supply constraints through the end of the year but they have started to moderate. 3Par revenue declined 9% due to a more competitive market in the US.

Networking revenue grew 16% driven by Aruba wireless solutions, which grew over 30%. We are also seeing Aruba lead to strong pull through of wired switching that grew mid-single digits, demonstrating the combined strength of Aruba and HPE. Networking is now seeing growth across all product groups and geographies.

Technology Services grew revenue for the fifth consecutive quarter, up 2% year over year. While overall orders were down slightly, we continue to improve service intensity, or attach dollars per unit, which helps offset pressure from declining hardware unit sales.

HPE Financial Services revenue grew 10%, its fifth consecutive quarter of year over year growth driven by lease conversions and an increase in operating lease mix. Financing volume, however, declined 8% due to lower indirect business. Operating profit declined 210bps year over year to 7.8% reflecting one-time items and the increased operating lease mix. We continue to see the strategic importance of financial services to our customers as flexible consumption pricing models gain momentum.

Software revenue was down 1% as growth in license and SaaS was offset by declines in Professional Services, with more emphasis on higher margin products. The operating margin was 24.9%, a 710 bps improvement year over year.

Looking back at the quarter, I'm pleased with the business performance and believe we have a strong portfolio of solutions and services that is clearly gaining traction with customers. Increasingly, we are seeing customers turn to us for a comprehensive IT strategy – from Hybrid IT to the campus to services. For example, last month we announced a new project with NASA, focused on developing a supercomputer that can withstand the harsh conditions of space. We also recently announced that HPE has been selected as the official IT networking and wireless infrastructure partner for the Tottenham Hotspur Football Club's new state-of-the-art stadium being built in London. And, Pointnext continues to add logos from around the world, including Siemens, Travelers and Saudi Telecom Company in Q3. Overall, we feel good about the momentum we are seeing and the opportunity ahead.

Now to cash flow…Free cash flow was better than expected at $428M, benefitting from continued improvement in working capital management and favorable CAPEX. The cash conversion cycle was down 5 days sequentially to negative 17 days.

Capital allocation during the quarter included $107M in dividend payments and $625M of share repurchases. We have now returned $2.3B to shareholders year to date and are on track to fulfill our full year commitment of $3.0B.

Moving to our software spin–merge transaction...We completed the Software spin on September 1st, on schedule and under budget. We continue to make progress removing stranded costs and remain confident we will eliminate all costs on a run-rate basis by the end of the fiscal year.

Turning to our outlook... as the software transaction is now complete, consistent with prior divestitures, the fiscal 2017 earnings outlook will no longer include Software for the last two months of the year. As a reminder, the impact of removing two months of Software from the full year FY17 earnings outlook is 13 cents, including 12 cents of earnings contribution and one cent of stranded costs.

With that, we expect to finish fiscal 2017 with non-GAAP diluted net earnings per share of $1.36 to $1.40. We expect GAAP diluted net earnings per share for to be ($0.11) to ($0.07).

Please note that our outlook does not include a likely material, non-cash tax benefit associated with potential corporate tax reform. We expect to undertake tax planning actions next quarter and are still working through the details, but we expect them to result in a material benefit to our Q417 and fiscal 2017 tax rate.

Also, as Meg mentioned, Hurricane Harvey has had a substantial impact to our Houston operations. Our top priority has been ensuring the wellbeing of our employees during this challenging time. From a business perspective, we're continuing to assess the impact. Fortunately, we have a limited amount of production in Houston, which we’ve been able to mostly shift to other locations, so we don’t expect a disruption to our customer deliveries. Of course, we will bear uninsured costs associated with lost inventory or repairs to our campus, but have not incorporated anything into our outlook at this time.

Finally, turning to the cash flow outlook. Year to date free cash flow is almost equal to our full year target. However, Q4 cash flow will likely be lower than in prior years due to less seasonal earnings uplift following the Software and ES divestitures, and the additional restructuring charges we are accelerating from FY18. As a result, we are maintaining our full year FY17 free cash flow outlook of negative $1.8B but do acknowledge there could be some upside. Additionally, we will need to make payments for previously agreed upon balance sheet adjustments to DXC and Micro Focus that are still be finalized, but still expect to end the year with an operating company net cash balance of approximately $6.5B.

Before we turn to questions I wanted to briefly address a few topics which may provide helpful context going into our October 18th analyst day.

First, we gave a view of FY17 Future HPE earnings during our last analyst day of $1.25 to $1.35. However, this did not account for $0.06 of stranded costs and the first quarter earnings takedown for currency and DRAM pricing of $0.12. Those two items would bring the FY17 outlook mid-point down to $1.12. We have also seen further commodity pressure, a more competitive pricing environment, and some dilution from M&A that reduce the FY17 outlook for Future HPE closer to just over $1.00.

Second, we are in the process of settling outstanding tax disputes that have already been reserved against but will result in approximately $300M of cash payments in FY18 that we think we can partially recover through foreign tax credits in future years.

Lastly, with regards to the HPE Next program Meg discussed, I want to provide some additional color on high-level expected savings before we provide the full details at our analyst day.

Based on our current assessment, we're committed to $1.5B of gross savings over the next three years. Keep in mind that this is a gross savings number and the net savings could be impacted by incremental investments, ongoing commodities pressure, and a continued competitive pricing environment. We are still working out the funding requirements for HPE Next, but we expect to partially offset any cash costs with real estate sales, including the Roseville site completed this quarter, and lower than expected separation costs. While we will provide more details about the HPE Next initiative at our upcoming analyst day, it is absolutely the right thing to do and will achieve a very attractive return on the required investment.

Overall, like Meg, I am very pleased with the progress made this quarter and am confident that our plan is the right long-term strategy to position us for success. I look forward to discussing the future of HPE at our upcoming analyst day.

Now let's open it up for questions.

QUESTION AND ANSWER

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

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

Katy Huberty
Thank you. Good afternoon, I just want to start with a clarification, Tim and make sure I understand your commentary around fiscal 2017 remainco earnings. So the way I read it is a $1 of earnings in fiscal 2017. If you back out software and services and so we should think about growing off of that base by some amount in fiscal 2018, is that right?

Tim Stonesifer
Yes, that's correct. If you take into account the stranded cost, the $0.12 take down, obviously we have some short-term dilution that we've been talking about these recent acquisitions, and then we continue to see commodity pressure in a very competitive pricing environment. The combination of those four things takes you down to about $1 by the end of the year.

Katy Huberty
Okay. Great, and then, just a question as well, how much of the $200 [million] to $300 million of savings would you able to capture in the third quarter, and on the same lines have you been able to pass through some of the higher component costs in the third quarter versus what you saw in the second quarter?

Tim Stonesifer

Yes, let me start with the $200 [million] to $300 million. So last quarter, when announced that, we thought roughly a third of that would happen in Q3 and two-thirds of that would happen in Q4. I would say we are tracking ahead of schedule, I mean, when I look at all the metrics, whether it you know, travel as an example is down 21%, if I look at contract or headcount, down 14%, rehire rates. So how many jobs we fill which is typically something very difficult for our leadership team to do, because obviously there is a lot of work that needs to be done, that's roughly half of what it was last year. So we are seeing very good progress there. Like I said, I would say more than a third is hitting in Q3 and we are confident that we'll get the rest in Q4.

As far as, the pricing component, we still see a very competitive environment out there, particularly in the US. So that is something we are not passing though as much as we like. Again, longer term, we think that we will be able to pass the commodity cost pressure through, because as an industry, I think folks are going to need to make money. But we are not gaining the traction that we had anticipated and that's why you are seeing the pressure.

Andy Simanek
Great, thank you, Katy. Can we have the next question please?

Katy Huberty
Thank you.

Operator
Our next question is from Toni Sacconaghi with Bernstein. Please go ahead.

Toni Sacconaghi
Yes, thank you. I have a question and a follow-up. I think your guidance for fiscal Q4 implies enterprise group operating margins at around 11%. I think at Discover, Meg you had commented on EG margins rebounding to similar levels as last year or 12% or 13%. Has your outlook for the recovery in Q4 changed over the last three months and can you help address that apparent disparity?

Tim Stonesifer
Yes, sure. So first of all, let me start with Q3 and we were pleased to see that margins were up 50 basis points sequentially. Again, a lot of that was driven by the cost savings that we had laid out on the 2Q call offsetting the pressure that were sitting from a full quarter of stranded cost as an example in ES along with the short-term dilution. So, as I look into Q4, I would expect those margins to improve. As we get more cost savings in Q4, as compared to Q3 although not as much as we had expected that's certainly going to be helpful from a margin perspective.

As you well know, Toni, if you just look at seasonality in EG, if you look at the last couple of years, we do see fourth quarter is our most profitable quarter. So, we should expect to see that same type of lift in Q4 of this year, and again, as we continue to eliminate the stranded costs and the short-term dilution as we right-size the cost envelopes of those acquisitions that will drive some margin improvement as well.

But, to your question, I would expect to see those margins at the end of Q4 to be closer to 11% and the primary reason is we continue to see commodity cost pressure. If you just look at memory as an example, we are still up another 5% or 10% versus last quarter. And again, we are not getting the pricing traction that we had anticipated and that's what's causing the incremental pressure.

Toni Sacconaghi
Thank you.

Meg Whitman
And adding to that, Toni, I think we can return to historic levels in 2018, but we are going to be probably a quarter or so delayed and we'll see what happens in commodity pricing and those other things, but I also think HPE Next will certainly help.

Toni Sacconaghi
And then, just to follow-up, Meg, I was wondering if you could maybe just clear the air on your commitment to Hewlett-Packard Enterprise. There is obviously been a lot of press, speculation about your potentially accepting a role at Uber as CEO, you had made statements saying that you are remaining at HPE. I was wondering if you could just clear the air on the apparent reporting discrepancies in your statements and where do you stand in terms of your commitment to HPE? Thank you.

Meg Whitman
Yes, sure. There has been some press. So, listen, I was called in very late in the Uber search and I thought it was a very interesting business model to me. It's actually quite similar to eBay in many ways. It's very disruptive, that relies on a community of drivers just like eBay relies on a community of sellers and the growth prospects reminded me of eBay in its early days and as, you know, I am also an investor in Uber, but in the end that wasn't the right thing. And I would say that has really nothing to do with HPE, which is quite special in its own right and we have a very focused strategy and a path forward to build a very big business on what I think is a quite compelling strategy, hybrid IT, edge computing, IoT and much more. And we also have a remarkable customer base and partner base. So, the other thing is I have dedicated the last six years of my life to this company and there is more work to do and I am here to help make this company successful and I am excited about the new strategy. So, lots more work to do and I actually am not going anywhere.

Toni Sacconaghi
Thank you.

Andy Simanek
Great. Thank you, Toni. Can we have the next question, please?

Operator
And our next question is from Sherri Scribner with Deutsche Bank. Please go ahead.

Sherri Scribner
Hi, thank you. I am sure you will talk about this at the Analyst Day, but when we think about potential fiscal 2018 earnings through the business now, clearly we've got somewhere around $1 in earnings this year for the remaining business. And when we think about things like stranded costs and higher commodity costs, it seems like those things probably should abate to some extent next year. So I am trying to understand how much of that are you expecting to abate, I think Meg just said, DRAM and commodity cost probably improve in fiscal 2018, but maybe it takes a quarter longer. Stranded costs should go away, should we be able to add at least some of that to that dollar number in fiscal 2018?

Tim Stonesifer

Yes, fair question. And we will certainly give you plenty of detail at the Security Analysts Meeting. But, just to help you frame it up, we should see some significant uplift from an EPS perspective in 2018 and let me just start with the tailwinds that we should see, so, to your point, stranded costs and also the short-term dilution from those, the recent M&A deals, that should come back and provide some tailwind for us in 2018, and you guys can quantify that based off of the color we had given.

The other thing that we should see some headwinds, although I am a little bit hesitant, is foreign exchange. I mean, if rates stay where they are today and hold, then that would certainly provide some tailwinds for us. Now, we'll have to see what happens at the beginning of the year, but as I said, if they hold where they are today, that should provide some uplift. Obviously, we are excited about HPE Next. We think that's going to yield some significant savings. Now we'll have to figure out the difference between the gross and the net, but overall, that should be positive. And then we should see some benefit from the lower share count. So those are all the positives we have going into the year.

As far as some of the pressure points that we'll continue to see, although DRAM may soften a little bit, just keep in mind, we are going to have a full year impact of that versus what we had this year. So we do expect that to be a significant pressure point going into 2018, when you compare year-over-year, DRAM cost will be roughly double. We are expecting and we will see what happens that we continue to expect to see a very difficult pricing environment. We are not anticipating that easing up in the near term. So that would provide some pressure and then we are obviously going to continue to invest in the business. But, net-net, hopefully that helps you frame it up, but given the positives and the negatives, we would certainly expect to see a significant uplift in 2018.

Sherri Scribner
Okay, great. Thanks for that. And then just a follow-up, can you maybe provide some additional detail on the strength that you saw in the server business? It seems that was much better than expected and it sounded like from your commentary that that was more specific to HP and you gained share. But, maybe some additional detail would be helpful. Thank you.

Meg Whitman
Yes, I'll take that and Tim can follow on. So, the results were quite a bit better in servers. Flat overall, but grew 12% to 13% excluding Tier 1. And I'd say there is couple of things going on, one is better execution, particularly in Americas, but actually across the board. And I think that execution will continue and we expect as we said, to gain a bit of share in the second quarter. There was also some improvement frankly in the overall market and in all fairness these were easy compares in Q3 than they were in Q1 and Q2. But, I also have to say the portfolio that we have worked hard to create, that we have pivoted to over the last couple of years, that is in faster growing more profitable areas in the markets is starting to kick in and you can see that in high performance compute; you can see it in synergies momentum that is not only the actual product of synergy, but it's actually accelerating the core blade business. We are also seeing good traction in hyper converge that grew triple digits, albeit off a small base. And then across Aruba continues to do very well. And interestingly on Aruba in the US, it reignited the wired networking business which was part of the thesis of the acquisition, but it's actually playing out very nicely in the United States.

So, listen, I think the market is going to continue to be competitive. We are going to continue to face some headwinds from Tier 1 that was down versus Q3. But, we are feeling much better about that core business and you really need to think about this as stabilizing the core transactional rack and tower business while we pivot the portfolio to higher margin and higher growth segments in the marketplace and that's working. The only thing I will say is what I've learnt over the last six years in this business, there is always something that could happen here, whether its floods in Thailand, floods in Houston, this is a remarkable situation that we face in Houston I have to say. And so, I feel good about our execution. I feel good about what we can control.

Andy Simanek
Great, thank you, Sherri. Could we have the next question, please?

Operator
Our next question is from Steve Milunovich with UBS. Please go ahead.

Steve Milunovich
Thank you. First question on CTP acquisition, it's quite interesting and I think a very, very good company, their primary business though I believe is trying to move on-premise customers to the cloud and particularly the AWS which is a kind of threat to your core business, but you feel that having that as part of a services offering, helping customers with hybrid cloud is more important.

Meg Whitman
So, listen, a core part of our strategy is we make hybrid IT simple. And what CTP does very well is very consistent with our strategy, which is what customers think to do is they just with their applications and their workloads. First, make sure that they've got, they've rationalized those workloads as fast and as much as they can and then decide where each of those workloads should go based on a total cost of ownership and how they want to pay for it, whether it be on consumption based pricing model or CAPEX. So, that's what this team does and we will add our expertise on on-prem private cloud. We'll add our expertise because we do some of this today and it's an opportunity to scale that practice. But listen, there are some workloads that customers probably should move to a public cloud and, you know, Azure is our public cloud partner. We are excited about Azure's stack on-prem. We aim to be the leader in infrastructure behind Azure stack on-prem. And so, we want to make sure that we help customers find their right mix of hybrid IT and this is a nice way to scale that business for us.

Steve Milunovich
Thank you. And then on the storage side, could you give us a sense of how much Nimble contributed to that revenue? I think you said 3PAR was down, was it 9% year-over-year? Is that an effective Nimble at all? Because I think you separated where those two are going into the market, so I wouldn't expect to see too much effect from Nimble on to 3PAR.

Tim Stonesifer
Yes, I would just say that All-Flash in general was up about 30% and roughly 6% organically. We did see some pressure on 3PAR to your point, that's primarily again we are seeing a very competitive pricing environment particularly in the US in storage in 3PAR.

Steve Milunovich
Thank you.

Meg Whitman
Yes, listen, we are excited now about our storage portfolio, 3PAR plus Nimble, we get incremental scale, we get InfoSight which is obviously you know AI for the datacenter in the context of Nimble. And I think one plus one here is going to equal more than two and we are

really pleased, we are going to combine the R&D. We are combining the sales specialist teams. We are leveraging, I think the strengths of both companies to give us more scale, particularly in the All-Flash segment of the market which is growing. And you will recall that only about 10% of datacenters have moved to All-Flash. So there is a lot of running room there and we are a leader in that marketplace and we aim to continue that trend.

Andy Simanek
Great, thank you, Steve. Can we have the next question, please?

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

Shannon Cross
Thank you very much. I am sure you will get into it in more detail at the analyst day, but can you talk a bit about your thoughts on cash and use of cash? Clearly, some will be used to fund the restructuring, but what are you thinking about in terms of acquisition strategy going forward and other ways to return cash to shareholders?

Tim Stonesifer
Yes, Meg you can jump in here afterwards. I think we are going to continue to operate within the framework that we have right, and we are going to be very disciplined. It's going to be returns based, and it's going to be a three-legged stool. So we are going to continue to focus on organic investments because when we do that well and we do it right, it's good for customers, it's good for partners, it's good for shareholders, think about All-Flash, think about synergy and those types of things. Obviously, we are biased toward share repurchases right now. And then we'll also look at M&A, again M&A that's complementary IP that helps leverage our distribution where we can then blow out some profitable growth. So I would expect this to continue to operate within that framework. And like I said, we will give some more color as we get into the analyst meeting in October.

Shannon Cross
Great, and then, I am just curious, when I look at the cost reductions that you are talked about travel down 21%, contract was down 14%. How much of this is recurring or can be continued and how much of it is just sort of a near term reduction in your spend? And I am just trying to figure out, does it make sense to travel down 21% to support the ongoing business or is this just in the interim while you are getting HP Next in place?

Meg Whitman
Well, let me give you a little context on that. So listen, there is obviously some short term cost reduction that we are doing. But I have to say, what we have done the $200 [million] to $300 million in Q3 and Q4 I do not think it's actually hurting the business. I think we are executing better than we were before and you can see that in our results. But as we move into HPE Next, it is a much broader initiative than normal cost reduction, we are essentially re-architecting the company to be precisely built to compete and win in our markets. And we are actually clean-sheeting, both the operating model and the organizational structure to simplify how we work, and we want to take actions that optimize business processes and operations.

And let me just give you a couple of examples of that, and this has all become very obvious as ES has moved out. When ES went to DXC on March 31st, a $28 billion business, 110,000 people left this organization, and it was in some way is like the tide going out. You could see where there were real opportunities to improve. And I'll give you a perfect example. Think about platforms and SKUs and options. So we have about 50,000 live configurations in our server business. The old 80-20 rule applies. And so, if we are to really focus on the configurations that make the most difference, this, well think about it, inventory, nodes, purchasing, supply chain, everything gets simpler and easier. Think about decreasing the layers in our customer-facing organization, so that there is more accountability and decision-making closer to the customers. Reducing the number of markets that we operate in to prioritize the customers and the countries that are driving the vast majority of the business today and will drive almost all the growth. So this is the kind of thing we are doing. So, yes, I think you know, the travel and the contractors are interesting and have not hurt the business, but the fundamental re-architecture and reengineering of this business is I think very, very exciting. I think it's going to be good for customers and it's going to be good for our speed and nimbleness and agility as a company.

Tim Stonesifer
And the only thing I would add to that is to Meg's point; a lot of the HPE Next stuff is very structural. So that will obviously be more run rate related. But keep in mind that the $1.5 billion savings is a gross savings number. So again, we are going to continue to see commodity cost pressure. One of the things you will see, that we did very effectively with ES is we are going to hire people as we shift rules from high cost countries to low cost countries, we are going to be out hiring people. And then we are going to continue to invest in the business. But net-net, it should drive some significant savings for the business going forward.

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

Operator
Our next question is from Jim Suva with Citi. Please go ahead.

Jim Suva
Thank you very much. Taking back and looking at a bigger picture of things, is Brexit now still a headwind to the company, are we turning the corner on Brexit? Can you talk a little bit about kind of your overall demand trends? As I know for a while there is a little bit of a pause or hesitation there. Thank you.

Meg Whitman
Yes, so listen, I think when Brexit was first announced, we did see a pause in the demand in the UK market. No, question about it, because customers were trying to decide, did they want to build their next datacenter in the UK or should they be building that datacenter someplace else in Europe. I think, we are still feeling some after effects from Brexit because it's not clear exactly how this is all going to work. So I would say, the UK market is a bit challenged for us, it's not only Brexit, it's also the public sector that is cutting back spending quite dramatically. So the UK is not one of our stronger markets. It's a very important market for us, but I wouldn't say it is doing, as well as, the rest of Western Europe, and frankly the United States, Canada, Latin America and Asia are all outperforming the UK right now.

Jim Suva
Great, thanks so much for the details.

Andrew Simanek

Perfect. Thanks, Jim. Can we have the next question, please?

Operator
Our next question is from James Kisner with Jefferies LLC. Please go ahead.

James Kisner
Thank you. So very nice work on servers, it's nice to see that business doing better. I was hoping you can dig into the success there. How much of that is really attributable to just product cycle with Synergy? I am also curious how you might expect the year-over-year growth rates in servers to trend over the next couple of quarters as the comps get a lot easier here in a couple quarters from now? And just separately and relatively on Cloudline, are you still committed to that product line and could you tell us how much of the business is coming from Cloudline? Thank you.

Meg Whitman
Yes. So, listen, I would say we are cautiously optimistic about our server business. So you're right, Synergy has made a difference, high performance compute has made a difference, SimpliVity has made a difference. And so, we talked about Synergy is also really helping our blade business, it's interesting, people are buying more C7000s, because there is a roadmap to a future state. So we are excited about that. I would also say Gen10 is a real opportunity for us. I mentioned in my opening remarks that Gen10 is now the industry's most secure server. This is a big issue now for everybody and we are the only server company that has built security into the silicon in our servers. So we are cautiously optimistic. I think, I would add commodity pressure, currency it's a very competitive pricing environment still. So the only reason, I am not even more enthusiastic is just there is challenges that remain in the market. We are executing a lot better here. Thanks to the US team. Thanks to EMEA and APJ and Latin America. We are executing a lot better here than we have in the past with the stronger portfolio.

Cloudline, you had a question about Cloudline. So listen, Tier 1 continues to be a headwind for us. It's a very lumpy business with not much profit attached to it. And so, we need to figure out what the long term answer is on Cloudline, and so, we are evaluating that right now. We will, I think have an answer by the security analysts meeting about what we want to do about Cloudline on a go forward basis.

And Tim you might talk a little bit about how much, I think he asked a question about how much…

Tim Stonesifer
That's roughly, call it, 10% to 15% of our Tier 1 revenue.

James Kisner
Thank you very much.

Andrew Simanek
Great. Thanks, James. Next question, please?

Operator
Our next question is from Ittai Kidron with Oppenheimer. Please go ahead.

Ittai Kidron

Thanks. Sorry to beat the dead horse here, but I am going to think it's the servers yet again. Can you perhaps give us the year-over-year growth rate actually excluding your acquisitions as well because there are two of them in the numbers which you did not exclude?

Meg Whitman
Okay, let's see. So you would like to know the number. So I can tell you, High Performance Compute was 40% with SGI and 10% organically.

Ittai Kidron
I am talking servers in total. You gave the number of 10% excluding Tier 1 and divestitures. But can you give it also excluding M&A. And the second point Tim, how much of the growth here is, you've managed to roll some of the price increases in DRAM into customers. I understand not all of it, clearly absorbing some of it. But, how much of the growth here is price-driven versus unit-driven?

Tim Stonesifer
So, on the organic piece, the M&A activity is roughly three points call it. And I am sorry, what was the second question about price?

Ittai Kidron
Yes, how much of the growth is driven by unit growth versus ASP growth, because you have managed to increase some prices. I understand not to the full extent of the DRAM increases but prices have come up to a certain degree. I am just trying to gauge how much of the growth here is really unit-driven versus ASP-driven.

Tim Stonesifer
Yes, I would say, its ASP-driven. But again, it depends on what product line you are talking about. If you are talking servers, its ASP-driven, so I'll just leave it at that.

Ittai Kidron
Got it. Okay, and then for you Meg, on storage, good results there. At the same time, when you get compared on the All-Flash progress compared to a net app or pure, you are still well behind from a growth standpoint. I am trying to gauge relative to the size of the business you have there, what in your opinion should the All-Flash array business grow at as we think about next year?

Meg Whitman
Yes, so, I think actually, we I think did a very good job of getting to All-Flash early with 3PAR and then of course Nimble and then the two competitors that you mentioned actually showed up with an All-Flash product quite recently and they've been able to mine their installed base which we understood would happen. So our objective is we got to go mine our installed base and then when a customer is thinking about upgrading to All-Flash, we got to make sure that we are in a competitive position there. I can't give you an estimated growth rate of All-Flash. What I can tell you is, it's faster, better, cheaper. And that is usually a winning formula for CIOs and we are seeing a huge amount of interest in All-Flash as CIOs continue to be under cost pressure and performance pressure, All-Flash is a natural opportunity for them. So, I don't know whether this will continue at a 30% growth rate, but it will be at least double-digits, I think for the foreseeable future, this is a fundamental trend in the datacenter.

Ittai Kidron
Very good, good luck.

Meg Whitman
Thank you.

Andy Simanek
Thanks, Ittai. Next question, please.

Operator
Our next question is from Simon Leopold with Raymond James. Please go ahead.

Simon Leopold
Thank you for taking my questions. I've got one question and a follow-up. First, I wanted to see if you could talk a little bit about your thoughts on the federal vertical and help us understand the sizing and what assumptions you've made or thoughts you have in terms of potential risk if there is a government shutdown?

Meg Whitman
So, the federal business is an important part of our business in the United States. I think it's roughly 10% to 15% of our revenue in the United States and we have an excellent position there. We've got longstanding relationships with almost every agency and every part of the federal government. So, a government shutdown would probably be a blip honestly for us. There would be a speed bump there. What I will say is a lot of these purchases are long head, they buy and then the delivery is over a long period of time. So probably that would not, if there was a government shutdown in October, that probably wouldn't affect us until a little bit later in 2018. But listen, the government shutdown I don't think is our friend or anyone else who sells to the government. That's not our friend and we certainly hope that will not happen.

Simon Leopold
Great. And then, in terms of the follow-up, I wanted to get a better understanding of how you are thinking about the campus environment, because you did talk about very strong Aruba business and you mentioned some pull through sales of upgrades, but if we look at the campus switching environment by itself, how is that trending for you? You've mentioned a couple of data points, but I want to see if we could quantify it. Thank you.

Meg Whitman
Yes, let me talk a little bit about Aruba and why I think Aruba is seeing the traction that they are seeing. First is, you hear about CIOs digitalizing their environment and their interactions with customers. How many times have you heard a CIO saying, "I've got to digitize my environment"? In many ways, Aruba is the wedge of how that gets done. Either they are transforming their employee environment in their campuses across the world. So that it is a more modern work environment, mobile first and fundamentally changing their employee experience or it is a customer who is saying, "I've got to change my interaction with my customers" and whether that is a retail environment, fast food, hospitals, government interaction.

So, Aruba is on the cutting edge of this digital transformation that every organization is undergoing and that is fundamentally what's driving demand. There is two things that differentiate Aruba. One is security. Whether that is ClearPass or Niara, we win on security virtually all the time. We have the most secure wireless network and that is an important decision criteria. There is also interesting things built into Aruba. They bought a company called Meridian which is wayfinding and GPS. So whether that is wayfinding through a large big box retail environment, whether that is wayfinding through a hospital, this is a very important application that rides on top of Aruba. The other thing is asset tagging. If you think about a hospital environment, most of their assets are mobile and at the end of every day they are never where they are supposed to be and the ability to asset tag and work through the wireless network has been a big selling point for a number of different customers.

So, listen, we compete hard every day there. But, it is a very rapidly growing market and we are gaining share in the campus branch and edge. So, listen, we expect that to continue. I think that the Aruba team would also tell you they have benefited by being a part of Hewlett Packard, because when they were Aruba, people loved the product, but some big companies were a little bit hesitant to sign on to a small independent start-up while part of HPE, they know we will stand behind Aruba and that has totally helped the revenue trajectory of Aruba. So listen, we remain optimistic and they have a fantastic product, well priced with an excellent sales force with terrific white glove service and that’s another differentiator.

Andy Simanek
Great. Thanks, Simon. I think we have time for one more question, please.

Operator
Your last question today will come from Ananda Baruah with Loop Capital. Please go ahead.

Ananda Baruah
Hi, yes. Good afternoon. Thanks for taking the question. What I’d really love is to get a little bit more of a view on is in regards to HPE Next, like what are some of the revenue initiatives that we might expect, and you just touched on them in your dialogue earlier, but what are some of those and what might, not quantify, but the types of impacts be that you guys are looking for? Thanks a lot.

Meg Whitman
Yes, so listen, we think HPE Next will have positive revenue accelerators and it really goes to two major initiatives, one is how do we make decisions on accountability much closer to the customer. So, that frontline sales executives; can make the decisions in the field faster. And that by increasing the agility and the decision-making, I think actually, we will do more business.

Another case on revenue acceleration is our ability to quote configurations much faster. We’ve made progress on this over the last several years, but we need to make more progress. And how we change our pricing and our quoting to be much more customer-focused and customer-friendly, I think is an important element for us. If you think about reducing the number of SKUs and options, this also makes it easier to sell, and faster to configure on offering and I think that will accelerate.

And then I mentioned, probably like most companies, a small number of countries account for the vast majority of revenue and profit and will account for the growth in our industry over the next five to ten years and we want to make sure we are allocating the resources correctly to the largest countries, with the countries that have the most growth and profit potential for us.

And so, I think that actually will accelerate. As you can imagine a 1% increase in the United States dwarf just about if you think of the long tail of countries, that dwarfs the revenue in those long tail of countries. So those are some of the initiatives that I think by extension will impact revenue to the positive. So, we are very focused on how do we be simpler to the business with faster to the business with, which should result in revenue increases.

Ananda Baruah
Really appreciate. Do you think you could see an impact in 2018 from any of these initiatives?

Meg Whitman
We do, actually we really do. We aim to go into FY 2018 with a clean sheet operating model in a way that I hope customers will see a difference right away and frankly it would be easier for our employees to get things done. If you think about what was required to hold this company together when it was a very large multi-business company, some of those ways of doing business, we need to let go off. And I understand why it was here, it was necessary in terms of growing together such a large company, but now that we are more focused with a focused strategy and a smaller company, I think we can do better in terms of making it easier for our employees to get things done.

Ananda Baruah
Really appreciate it. Good luck.

Meg Whitman
Thank you very much.

Andy Simanek
Thank you, Ananda. Appreciate it. I think with that we can close the call.

CONCLUSION

Operator
Ladies and gentlemen, this concludes our call for today. Thank you and enjoy the rest of your day.