

Hewlett Packard Enterprise Company

Fourth Quarter 2018 Earnings Conference  
Call

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**CORPORATE PARTICIPANTS**

**Antonio Neri** - *President, Chief Executive Officer*

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

**Andrew Simanek** - *Head, Investor Relations*

## **PRESENTATION**

### **Operator**

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

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

### **Andrew Simanek**

Good afternoon. I am Andy Simanek, Head of Investor Relations for Hewlett Packard Enterprise. I would like to welcome you to our fiscal 2018 fourth 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 a press release and the slide presentation accompanying today's earnings release on our HPE Investor Relations webpage at [investors.hpe.com](http://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. 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 annual report on Form 10-Q for the fiscal quarter ended October 31, 2018.

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

Finally, please note that after Antonio provides his high-level remarks, Tarek will be referencing the slides in our earning presentation throughout his prepared remarks. As mentioned, the earnings presentation can be found posted to our website, and it is also embedded within the webcast player for this earnings call. With that, let me turn it over to Antonio.

### **Antonio Neri**

Thanks Andy, and thanks to everyone for joining us on the call. Hewlett Packard Enterprise delivered another strong quarter in Q4, concluding a very successful fiscal year 2018. As we close my first fiscal year as the CEO, I am thrilled with where we stand in the marketplace and I'm very excited about our team and our strategy.

Our strategy should be familiar to all of you at this point. We are accelerating growth in the Intelligent Edge, delivering profitable growth in the Hybrid IT space and continuing to grow operating profits and expand margins, all while investing for growth in the future. To do that, we have been driving a very deliberate strategic shift of our portfolio, which we first laid out for you at the Security Analysts Meeting in 2017. We have been focused on executing against that strategy, and we have delivered on what we said we would do.

In fact, we exceeded the revenue growth, non-GAAP operating profit, non-GAAP earnings per share and free cash flow targets that we set at the Security Analyst Meeting over a year ago. We are driving both meaningful top line growth and margin expansion, fueling shareholder returns. And we are doing all of that while simultaneously advancing our innovation agenda, laying the foundation to deliver value in the future to customers, partners and shareholders.

Fiscal year 2018 shows this strong momentum I'm talking about. For the full year, we grew revenue 7%, well above \$30 billion, which is even slightly higher than I predicted at our 2018 Security Analysts Meeting in October. We achieved 13% growth in our strategic Intelligent Edge segment for the year, with \$2.9 billion in revenue. We grew our large Hybrid IT business this year by 6% to over \$25 billion.

Our growth this year was nicely balanced from a geographic perspective with particular strength in EMEA. I commend our team in Europe for executing very well on their go-to-market priorities and gaining traction in the value segments, which are particularly strong results against a backdrop of political and economic challenges in that region throughout the year.

At the same time, even as we drove impressive growth, we also expanded profitability in fiscal year 2018, generating \$2.8 billion in non GAAP operating profit. That is an increase of \$576 million in profit, over the prior fiscal year. This profitability enabled us to exceed our free cash flow targets generating \$1.1 billion for the year, largely powered by strong cash flow from operations of \$3 billion which more than doubled over the prior year. Lastly, we also returned more than \$4 billion to shareholders in fiscal year 2018.

Our performance in fiscal year 2018 tells me that we have the right strategy at the right time, and that we have the right leadership team driving innovation and execution. We have strong momentum across our differentiated portfolio as we head into an expected healthy IT spending environment in 2019.

Let's take a quick look at our portfolio. Our competitive differentiation is becoming increasingly clear to customers; this should be to all of you as well. At Discover Madrid last week, and at the Security Analyst Meeting in New York in October, we talked a lot about our unique ability to advance our customers' businesses. We do this through a strategic mix of products and services that address their current needs while also helping them transition to an edge centric cloud-enabled and data driven enterprise of the future. So how are we doing that?

First, we believe the Intelligent Edge is the next frontier, and it is our top strategic priority. 75% of the data is created at the Edge and our customers increasingly need help turning all their data from the Edge to the Cloud into Intelligence they can use in real time. This business is growing double-digit, up 13% for the full year. All three categories within this business, campus and branch, edge compute and Aruba services are demonstrating meaningful growth. And as more compute capacity moves to the Edge, we expect this business to continue to be a driver for us.

Our Hybrid IT business, which includes compute, storage, data center networking and our Pointnext services business also had solid year-over-year growth in fiscal year 2018, up 6%, coupled with meaningful operating margin expansion of a full percentage point.

The secret of our success in Hybrid IT is that we continue to focus deliberately and successfully on portfolio mix. Our compute value offerings grew 9% for the year, including the 25% growth in high performance compute. Also our composable offerings with HPE synergy had an incredible year growing over 280% and reaching an annual run rate of over \$1 billion. And even as we orchestrate the shift from volume to value, we still posted better than expected results in our compute volume offerings that were up 7% for the year.

We also continued to be very focused on our storage business, and we saw 13% growth in the business. As we move into our fiscal year 2019, customers continue to see strong value in our nimble and 3PAR platforms with HPE InfoSight, enabling customers to operate more efficiently in our autonomous data center.

Finally, our HPE Financial Services business continued to serve a strategic role for our customers. It is a critical piece of our overall offering, affording customers flexibility in how they consume technology and often helping them to unlock value trapped in their own balance sheets. HPE financial services' core capability stands behind our HPE GreenLake model and every GreenLake contract includes 100% attach of our PointNext operational services offerings. We are delivering these benefits for customers while growing our financing volumes and achieving a double-digit return on equity.

In short, we are becoming more selective in where we are investing for growth, and improvements you see in our overall margins shows this approach is paying off. Tarek will take you through our Q4 results in a moment, but before I turn the call over to him, let me offer some final thoughts on the opportunity I see for Hewlett Packard Enterprise moving forward.

The ongoing explosion of data is powering the Intelligent Edge, creating \$140 billion, opportunity. As you know, we have committed to invest \$4 billion over four years to capitalize on this market. Meanwhile, our Hybrid IT market opportunities remain enormous at \$185 billion, and we see no end in sight for the mix shift from volume to value. We continue to see great momentum in the ongoing shift to hyperconverged and composable infrastructure, which is driving our customers' portfolio mix.

The other major trend we are benefiting from is customers' increasing demand for flexibility, both in term of how they deploy infrastructure and how they pay for it. By disaggregating the hardware and software elements of the infrastructure, we can give customers the cloud experience and economics on-premises, with applications deciding where they should run in a most efficient way.

HPE GreenLake is our flagship offering here, combining a cloud-like experience for on-premises infrastructure, letting customers pay as they go and only for what they consume. Today, we already have more than 400 customers using our consumption-based model. We estimate this is over \$2 billion of total contract value including hardware. Along with our HPE Synergy platform, these solutions help our customers decide how they use infrastructure and run the application in the most efficient way.

One of the recent developments I want to highlight is the acquisition of BlueData, which takes our consumption model a step further into AI, machine learning and big data analytics. BlueData has developed an outstanding "as a service" software platform that uses containment technology to

make it simpler and more cost effective to deploy large scale machine learning and big data analytics environments. It is complementary to our Apollo systems and Professional Services, extending our data first strategy. By seamlessly combining the software platform with our existing software-defined infrastructure and services, we'll be able to help our customers accelerate their AI and big data transformations, and better extract insight from their data whether on-premises, in the cloud or in a hybrid architecture.

Overall, our unique offerings have positioned us right where I want us to be as a powerful force as we shift the way customers are generating and utilizing data in their businesses. Across all area of the business, we have put in our customers at the center of everything we do and that's reflected in our performance, customer feedback, and recent customer wins.

For example, we recently supported the Lufthansa Technik to create a wireless access point for an Inflight Entertainment System, utilizing our Edge-Mobile-First Campus products. This wireless access point model is one of the most advanced in-flight wireless networks in the sky. HPE also signed two multimillion dollar contracts with Grupo Santander in Spain and Mexico for the deployment of Santander's global cloud, based on HPE Synergy. And we had a significant HPE GreenLake win with Danfoss, the largest manufacturing company in Denmark.

Looking ahead to 2019, I have great confidence that we will continue to build on all of this momentum. We will continue our work to accelerate growth in the intelligent edge, deliver profitable growth in Hybrid IT, and balance all of this with continued cost savings from HPE Next and resulting margin expansion.

Now, before I turn the call over, I would like to formally welcome Tarek to his first earnings call as a CFO. As you know by now, Tarek joined us in September 17, and jumped right in, quickly getting up to speed on HPE's strategy and financial commitments so that we can continue to deliver for our customers and partners and drive significant value for our shareholders.

I hope many of you had the opportunity to meet and speak to Tarek at the Security Analyst Meeting. We are very fortunate to have him on the team and will continue to benefit from his financial expertise, his customer-centric mindsets and insight, and his industry segment knowledge. Tarek?

### **Tarek Robbiati**

Thank you very much Antonio. It's a real privilege for me to report Hewlett Packard Enterprise's quarterly earnings for the first time in my new role as CFO. In my view, there is great potential at HPE. No other company has the full suite of assets and channel capabilities needed to compete across the edge to cloud continuum.

Two and a half months into the role, I am very excited to be part of HPE's leadership team as we guide the company and our customers into the next phase of a technology-led transformation. But before I share with you our results in detail, I would like to take this opportunity to thank my predecessor, Tim Stonesifer, for the hard work that stands behind HPE's strong fiscal year 2018 performance and a great handover between us.

Now, let me share with you our financial results for the quarter, and I will be referencing the slides from our earnings presentation to better highlight the strong momentum of the business throughout fiscal year 2018.

Starting with slide one, you will see that our Q4 financial results were very strong. We ended the fiscal year with robust revenue growth, significantly improved operating margins, better than expected non-GAAP earnings and free cash flow.

Our results demonstrate our ability to grow free cash flow by accelerating growth in the Intelligent Edge, driving profitable growth in Hybrid IT, and continuing to grow operating profits by expanding operating margins through HPE Next and also by shifting the portfolio mix to higher margin and better services attached offerings.

The punch line is that our resulting growth of 49% year-over-year in cash flow from operations demonstrate that our strategy is bearing fruit.

From a macro perspective, IT spend continues to be strong and customer demand remains healthy heading into fiscal year 2019. The market remains competitive but pricing remains rational and we are holding on to favorable pricing with improving commodities costs to expand gross margins.

DRAM cost has peaked and are starting to come down. NAND prices, while less of an impact on our portfolio continue to decline. Currency drove a 50 basis points tailwind to revenue year-over-year. Having said that, foreign exchange rates continued to move unfavorably the last couple of quarters and we now expect currency to be a headwind of closer to 2 points of revenue growth in fiscal year 2019.

Looking at slide two, total revenue for the quarter was \$7.9 billion, up 4% year-over-year and 3% in constant currency. Top line performance in fiscal year 2018 was driven by strong execution in a healthy demand environment that we expect to continue heading into fiscal year 2019.

Slide three and four, give you a geographic breakdown for the quarter. Regionally, HPE's performance was solid across the globe. Americas revenue was up 3% in constant currency. Core compute, which excludes mission-critical systems and Tier 1 and Intelligent Edge both grew double-digits in constant currency. Revenue growth in EMEA continued to be strong, up 8% in constant currency, with double-digit growth in the U.K., France and Italy. Performance in EMEA was robust across all business segments with notable growth in core compute at 24% and Intelligent Edge at 14%. Asia Pacific was down 4% in constant currency, due to our focus on profitable share in the China market. Growth in APJ excluding China was up 2% with solid results across all business segments, with notable strength in core compute which grew 18%.

Slide five shows our performance in the quarter by segment. I won't take you through every number, but the key takeaway is that from our portfolio mix perspective we are winning where it matters. We maintained robust double-digit growth in our strategically important Intelligent Edge segment. In Hybrid IT, our compute value portfolio grew over 20% this quarter. And within HPE Pointnext, our operational services business grew orders and revenue by 2% in fiscal year 2018.

Overall, we are confident in sustaining robust revenue growth as we continue pivoting our business towards higher margin, higher value offerings and improve our performance in our services business in fiscal year 2019.

Turning to margins on slide six, we continue to deliver significant margin expansion as a result of focusing on profitable growth in Hybrid IT, shifting our portfolio towards higher value, higher margin offerings, and continuing to drive HPE Next initiatives.

Gross margin of 30.9% was up 120 basis points year-over-year and 20 basis points sequentially. Non-GAAP operating margin of 10.1% was up 190 basis points year-over-year and 50 basis points sequentially. HPE Next has been an incredible success story for us this year and we expect to continue reaping the operating margin expansion benefits delivered by HPE Next for years to come to drive operating leverage and cash flow growth.

Moving on to slide seven, non-GAAP diluted net earnings per share of \$0.45 in Q4 of fiscal year 2018 was above the high end of our previous outlook of \$0.39 to \$0.44 per share due to strong operational performance, favorable other income and expense, and a lower than expected tax rate. This marks the fourth consecutive quarter we exceeded the high end of our outlook range.

GAAP diluted net earnings per share was a \$0.52 loss, below our previously provided outlook range of \$0.16 to \$0.21 per share, primarily related to the impact from U.S. tax reform which was a drag of over \$0.85 to GAAP earnings this quarter. Without the impact, we would have exceeded our outlook on this metric as well.

Now, turning to the segment and business units, starting on slide eight. In the Intelligent Edge, revenue was up 17% year-over-year and 15% in constant currency which strength across all regions. Operating margins of 10.1% were down 240 basis points year-over-year due to on-going significant investments in sales and R&D as we continue to manage this business for growth and share leadership in the \$140 billion Intelligent Edge market opportunity.

Aruba product grew 17%, with continued strong growth across all product categories including campus switching, wireless LAN and edge compute. We continued gaining share in the campus switching business, recording seven consecutive quarters of share gain, and saw notable triple-digit growth in our Edge Compute business.

Aruba services was up 16% on continued installed base growth due to strong attach of our software platform like ClearPass for secured network access control. As you can see from the revenue mix chart, Aruba services represents today a small portion of Aruba's total revenue, which highlights great potential for the upcoming years.

Moving on to slide nine, in Hybrid IT, revenue was up 5% year-over-year and up 4% in constant currency. Operating margins were 11.9% up 210 basis points year-over-year and 130 basis points sequentially, in line with our expectations.

Compute revenue was up 9% year-over-year and 14% excluding Tier 1. As a reminder, Tier 1 was over 20% of our Compute portfolio a couple of years ago and is now under 10%, which is a proof point of our commitment to improving our portfolio profitability mix.

Our Compute value business which has higher margins and better services attached has continued momentum growing at over 20% year-over-year. This was driven by our hyper-converged portfolio which includes Synergy up triple-digits and currently at over \$1 billion revenue run-rate, also our high performance compute category which was up over 50%, and finally mission-critical servers which was up 14%.

Revenue growth in our volume business was once again higher than planned in the high single-digits, excluding Tier 1, driven by strong growth in core rack and tower. Also, we continued to drive higher AUPs in total compute which was up 20%, excluding Tier 1, by increasing our mix of Gen10 servers with richer attach configurations, maintaining pricing power and to a lesser extent, passing through elevated DRAM costs. As expected, unit declines, excluding Tier 1, moderated

to mid single-digits this quarter and we are confident that we can continue to offset moderating unit declines with structural AUP increases heading into fiscal year 2019.

Storage revenue was up 6% year-over-year as customers embraced our intelligent storage offerings embedded with our AI-based predictive analytics InfoSight platform and we improved our go-to-market execution. Big data had another strong quarter, growing at 92% year-over-year, which will further benefit from our recently announced acquisition of BlueData. Entry storage growth was also solid. Looking forward into fiscal year 2019, we are pleased with our full portfolio across Nimble and 3PAR and we expect to gain share in the external storage market.

HPE Pointnext revenue declined overall 3% year-over-year due to our continued intentional exit from low-margin countries in the Advisory and Professional Services business, but it was flat on a full year basis and would have been up 1%, normalizing for those country exits. If you look at our higher-margin Operational Services business, revenue was up 2% on a full year basis.

Looking into a fiscal year 2019, we see continuous growth in Operational Services orders as we expect favorable mix from our value offerings that have better services intensity, and from our consumption-based offerings with HPE GreenLake, which grew orders at a 30% year-over-year rate in constant currency this quarter.

Moving to slide ten, HPE Financial Services revenue declined 7% year-over-year and 5% in constant currency due to a large one-time lease buyout deal in the prior year period. Normalizing for this one-time buyout, revenue was up 3% year-over-year. Financing volume remains strong across all regions and was up 8% year-over-year with solid growth in our direct business. Operating margin increased 20 basis points year-over-year to 7.8%. We are very pleased with HPEFS performance and look to accelerate its contribution to the business for years to come.

Now turning to cash flow on slide 11. Free cash flow was \$1 billion in Q4, in-line with our expectations, and consistent with prior year seasonality. Cash flow from operations growth has been significant in fiscal year 2018 driven by HPE Next and shifting our portfolio mix to where we want to win. That is where we have higher margins and better services attach.

In fiscal year 2019, we expect free cash flow to be \$1.4 billion to \$1.6 billion as we announced at SAM, a significant improvement compared to this year. We also expect our cash flow seasonality to be similar to prior years, where the first half is a use of cash with particular emphasis on Q1, and then we generate significant cash in the second half of the year, primarily in Q4.

With respect to our capital management strategy and as part of our continued \$7 billion capital return plan through fiscal year 2019, which we announced in Q1, we returned \$1.1 billion to shareholders during the quarter. This includes the previously announced 50% dividend increase totaling \$164 million in dividend payments. We repurchased \$983 million shares in the quarter and exceeded our \$3.5 billion buyback target for fiscal year 2018.

Finally, as you can see from slide 12, our balance sheet remains strong and we ended the quarter with an operating company net cash balance of \$3.1 billion. Looking into fiscal year 2019, we expect to return approximately \$2.9 billion, which is the remainder of our \$7 billion capital returns program, thus delivering on our commitment to shareholders.

Antonio provided our fiscal year 2018 performance overview, but let me recap it here now that you've seen the quarterly results. Fiscal year 2018 was really an outstanding year as you can see from slides 13 to 16.



For the full year, we grew revenue by 7% year-over-year with notable growth in compute value at 9%, storage at 13%, and edge at 13%. We grew non-GAAP operating profit by 26% and delivered a non-GAAP operating margin of 9%, which was up 140 basis points year-over-year and in-line with recent communications. We executed well on HPE Next, pivoted our portfolio mix toward higher value, higher margin offerings, which came with better Pointnext services attach, and grew our consumption-based services business.

Also, we delivered non-GAAP EPS of \$1.56, above our most recent outlook of \$1.50 to \$1.55, and well above our original SAM 2017 outlook of \$1.15 to \$1.25, a growth of over 60% year-over-year from continuing operations.

Cash flow from operations were at \$3 billion, a growth of over 120% year-over-year, while free cash flow came in at \$1.1 billion, significantly above our fiscal year 2017 levels, and above our fiscal year 2018 guidance. In summary, we have far exceeded our full-year revenue, operating profit, and cash flow commitments outlined at SAM in 2017. This demonstrates that we have the right strategy and our execution remains robust.

Now, turning to our outlook on slide 17. At our recent securities analyst meeting, we provided our outlook for fiscal year 2019 and I would encourage you to review my presentation for a more detailed discussion of that outlook. It's worth reiterating a few points for this call. From a top-line perspective, we expect to grow our fiscal year 2019 revenue adjusted for lower-margin Tier-1 business and currency fluctuations. Also, we expect to grow our fiscal year 2019 non-GAAP operating profit by 6% to 8%. As a reminder, we will be removing non-service pension costs and benefits from our non-GAAP results.

Consequently, our fiscal year 2018, non-GAAP EPS adjusted for pension accounting and taxes would be \$1.45. We finished the year better than what we flagged at our 2018 SAM. Looking forward, our fiscal year 2019 guidance is unchanged with diluted net earnings per share of \$1.51 to \$1.61 for non-GAAP EPS, an 8% improvement over the prior year, and our GAAP EPS outlook remains \$0.73 to \$0.83 per share. Finally, for Q1 2019, we expect diluted net non-GAAP EPS of \$0.33 to \$0.37 and diluted net GAAP EPS of \$0.19 to \$0.23.

So overall, I am very pleased with the performance, not just in the quarter, but the full fiscal year. We have the right vision and execution, and the results show that we are winning where it matters. With that, now let's open it up to 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 the question, please press "\*" then "2." We also request that you only ask one question and one follow-up question.

Today's first question will be from Katy Huberty with Morgan Stanley. Please go ahead.

### **Katy Huberty**

Thank you, good afternoon. Sorry about the voice. Just two quick questions, I'll ask them at once. The first is, how would you break down the server revenue growth in the quarter between units and ASPs and then you mentioned a couple times in the call that you expect robust demand

to continue into next year. What are the signals that give you that confidence, given everything that's going on in the macro environment? Thank you.

**Antonio Neri**

Hi Katy, this is Antonio. First of all, I hope you get well soon. I will answer...

**Katy Huberty**

Thank you.

**Antonio Neri**

...the second question. First, about the macro environment. The reason why I'm confident is because we see ongoing demand from customers and that demand is driven by the amount of data we are creating...we are generating. And obviously, regulations like privacy and others requires that data be stored, to be managed, to be curated, and obviously extract the value as soon as possible. So it's a function of the data, and if you look at the charts, actually the data growth outpaces the compute growth, which means the compute growth has to catch up sooner rather than later.

From my vantage point, as long as that data continues to grow, and I mentioned this before, two years from now, we're going to generate twice the amount of data we generated in human history. That means that data has to be computed and today, only 6% of that data has been utilized, the other 94% has not been utilized. So from that point, I feel very good and confident about the ongoing demand, and we see that in the momentum we had in the last few quarters, and at this point in time, I think that will continue.

In terms of the server AUPs, listen, as we said before, it's all structural. This quarter actually, if you recall two quarters ago, I said, as we exit 2018, we will see mitigated declines in units and that's exactly what happened here, has been very low, single-digit decline in units, and the rest is all structural AUPs driven by the mix shift to Gen10 which drives more option attach and then ultimately the elevated DRAM price is still there although now started declining, but the fact of the matter is that, these servers, this compute platform will continue to add more and more options, and therefore the AUP structural changes are permanent as we go along.

**Andrew Simanek**

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

**Operator**

Yes, next question will be from Simon Leopold with Raymond James. Please go ahead.

**Simon Leopold**

Hi, guys. I wanted to see if you could speak about how you see the trajectory for the server markets excluding the hyperscale portion and how much this is imposed by the macro and other factors and just, I'll just add in there, are you expecting any changes in the competitive dynamics with Dell considering its plan to come back into the public space now and its assertion that the integration with EMC is complete?

**Antonio Neri**

Yes, we have a very deliberate strategy to shift from volume to value. Despite that, the volume business grew 7% for the year which is good, and our value business grew 20% year-over-year and that's because the software-defined infrastructure is the perfect architecture to deploy on-premises against the specific optimized workload solutions that customers are looking for. When

I look at that value business, our HPC business, our high-performance compute business, grew 25%, and that's driven by the big data analytics and specific segments like government, oil and gas, weather and academia. If I look at the hyperconverged business growing triple digits, if you look at our Synergy business, it grew 280%, but now it's already a \$1 billion run rate.

All these platforms actually drive higher services attach with Operational Services, and so we continue to believe that's going to continue to grow and everything we have done is deliberately to shift to that model, not just from the engineering perspective, but as well as from the go-to-market perspective because the way we actually incent our people is to go sell solutions that are workload optimized. So I feel very good about that, and we expect that to continue whether it's on-prem cloud infrastructure or mission-critical applications. In fact, our mission-critical business, think about workloads like HANA or SQL or Oracle. Actually that business grew 35% which is very very strong. So I feel good about that.

Now, in terms of the Tier 1 business or the hyperscalers, we made that decision almost two years ago. And to Tarek's comments, used to be 20% of the business, now it's less than 10% of the business, and we have been very deliberate about that, because there were no margins to be made or at least not the one that we wanted to make, and number two there was no services pull through associated with that. So we are set on our strategy and that's what we're executing.

Well, listen, I'm focused on my strategy, and listen I'm very pleased and proud of what I've done here in the first year with my team. We're growing revenue in the company in the high single-digit, we are expanding profitability by 63% on our earnings per share. We are returning \$7 billion of cash or capital to shareholders and we are validating our strategy with customers every single day. Last week at the HPE Discover in Madrid, we had more than 10,000 customers come in and telling us we are on the right path.

**Simon Leopold**

Great, thank you.

**Andrew Simanek**

Great, thank you, Simon. Can we go to the next question, please?

**Operator**

Yes, next question will be from Tony Sacconaghi with Bernstein. Please go ahead.

**Tony Sacconaghi**

Yes, thank you. Two questions, please. First, I am wondering if you can comment at all on the impact of tariffs. I think as of November 1, you increased pricing on Aruba by 10%, and I'm wondering would you continue to increase price if there was a change in tariffs and did you see any kind of pull in advance of the price increases that benefited Aruba in the quarter. Could you comment on that, please?

**Antonio Neri**

Yes, Tony. So yes, we increased prices like any other competitor has done. Remember in the U.S., tariff there were four phases. The first two phases, we managed it, there was no impact to us. The third phase is exactly the one you are talking about, the 10%, and as you read the last few days, it's uncertain what is going to happen on January 1<sup>st</sup>. We'll see the outcome of the negotiations, but we increased prices 10% and we saw no pull up because of that price increase expected on November 1<sup>st</sup>, so there was no incremental benefit for Q4, so that's the bottom line.

As this new, whatever, tariff comes in play. We're already working on two aspects of it. One, obviously, is the pricing side, but the other one is the supplier side. So we continue to work with our supply chain, our suppliers to figure out what is the long-term strategic option here. But we need to wait, what's happening with the negotiations because at 10% it makes no sense to change anything, at 25%, obviously, you have to consider other options.

**Tony Sacconaghi**

Okay, thank you for that. And then I'm just wondering, I don't think you commented on what the ...or maybe I missed it and I apologize, on what the services Operational support growth was specifically in Q4. And I understand the move to value, but I was under the impression that support services are largely correlated to unit growth and with unit growth down again, mid-single digits this quarter and down, I think double-digits for the year, is it really realistic to believe that high margin Operational Services can grow in fiscal 2019 and if so, why? Thank you.

**Tarek Robbiati**

Alright. So with respect to the Operational Services orders in Q4, they were down as we pulled through some of those orders into Q3. In the course of the fiscal year 2018, overall OS services orders were up 2% as I mentioned in my script. Moving forward to fiscal year 2019, Tony, the thing that one has to factor in is, what Antonio said with respect to the categories of products that we are selling, they drive higher services attach. We do expect continuous growth in OS services in fiscal year 2019, as a result of a shift in the category mix that we are driving right now with our strategy.

**Antonio Neri**

Yes, Tony, another point I want to make is that units is one thing, but also remember the Operational Services ratio of what we call the intensity rate is a percentage or a correlation to the average unit price of the unit. So you can't just use units, you have to use the penetration rate and the intensity rate associated with that. And as the AUP goes up, reality on the compute side, the reality is, that you are supporting more components in that platform, therefore the services component of that goes with it, as a ratio. So that's why we are confident that in 2018 our Operational Services orders or the bookings will continue to grow as we continue to shift through the more blocks of IT which is value oriented.

**Andrew Simanek**

Great, thank you, Tony. Can we go on to the next question, please?

**Operator**

Yes, the next question will be from Shannon Cross with Cross Research. Please go ahead.

**Shannon Cross**

Thank you very much. I wanted to talk a bit about operating cash flow and free cash flow. Both AP as well as AR were uses of cash benefit from inventory, if you can just talk a bit about some of the moves there and then how we should think about fiscal 2019. I know you reiterated your guidance, but maybe if you can provide some reminders about what's non-recurring that hit this year that gives you comfort in the higher guidance for next year or the growth next year.

**Tarek Robbiati**

So, you can refer to the presentation and specifically on slide 11 with respect to the operating cash flow trends, versus the total free cash flow trends. The one thing that you wanted me to comment on is the role of inventory in the quarter. We have sold more of our own manufactured

products and that's why when you calculate the impact on free cash flow you have to factor in the movement in inventory.

The growth in overall operating free cash flow is very very tangible, and the best way to see the sources of the growth in operating free cash flow is to look at the margin expansion in our operating profit, between the first quarter 2018 versus the fourth quarter 2018 exit. You can observe, for example, that the first quarter 2018 we finished OP at \$593 million, and whereas in the fourth quarter of fiscal year 2018, we exited with close to \$800 million in operating profit and that is what is standing behind the growth in overall free cash flow. So that is sustainable, that is what is being driven by the HPE Next program and we keep a tight lid on the benefits and run rate benefits that HPE Next has delivered to us, and this is what stands behind the growth that we foreshadowed at SAM in October 2018 for fiscal year 2019 and beyond.

And with respect to the non-recurring item on free cash flow, there will be more of that in the 10K that we will file in the upcoming days. But suffice to say that they are recurring charges in the amount of \$531 million that we took for the full year, some IT costs, some consulting fees that were one-offs and other non-recurring charges, a total of which is about \$800 million give or take. You'll see all that breakdown in the 10K that we will file in the upcoming two weeks.

#### **Antonio Neri**

I would say, Shannon, we are very confident about our 2019 and 2020 guidance. As you recall at the Securities Analyst Meeting, we said we are going to grow 50% free cash flow between 2018 and 2019 and we're going to double it by 2020, and that's because all the leverage that we get through HPE Next, the portfolio mix shift that we talked about and I will say we are executing, we are executing exactly what we committed to a year ago and this year has been really good from that vantage point.

#### **Shannon Cross**

Thank you. And then, can you just talk a bit more about China and some of the pressure you are seeing there? I am curious if the declines we saw this quarter on a year-over-year basis sort of give us an idea of the magnitude of what you are walking away from for the foreseeable future or what specifically is going on there as you walk away from unprofitable contracts? Thank you.

#### **Antonio Neri**

Yes, so let's remind ourselves what the model for us is in China. We have a joint venture, although we own only 49% of that joint venture and we resell our products through H3C or the new H3C which is the company that we actually sold to the Unigroup, couple or three years ago. And so, they make their own choices, so they are trying to balance profitability and growth. And there were demand in certain areas of the portfolio including hyperscalers, that they decided not to participate. So from that perspective, we actually, kind of, at arms length, if you will we just sell through them and they make their own choices. So we work with them on an on-going basis because ultimately, they are the ones that make those decisions.

#### **Andrew Simanek**

Perfect. Thanks, Shannon. Can we move to the next question, please?

#### **Operator**

Yes, the next question will be from Paul Coster with JP Morgan. Please go ahead.

#### **Paul Coster**

Thank you. I wonder if you can just give us a little bit of color on the edge compute growth trajectory relative to everything else. And do you see any cross-selling synergies with your broader Hybrid IT offerings?

**Antonio Neri**

Yes, so the edge compute business is growing significantly. This is driven by the use cases in specific verticals. We see that in manufacturing. We see that in hospitals, as the IoT part of this and the convergence of both the OT, operation technology and IT becomes a reality, that's the big advantage that we have. We are one of the only vendors that have a true converge OT and IT platform and I can tell you it's growing triple digits, and obviously we expect that to continue to be the case, but more and more it's a vertical solution top to bottom from infrastructure, to software, to analytics, to connectivity and security. And, that's why the combination of Aruba with networking, connectivity and security with an edge compute allows us to provide full-blown solutions for customers.

So that's what we see at this point in time. And definitely, there are the synergy because all the large deals that we see with Aruba are the reasons that happen through our cross synergy on our go to market with Hybrid IT. More and more we sell an edge to cloud architecture. We sell the campus and branch solutions with Aruba, in verticals we sell edge compute and then we sell the cloud. The cloud, call it on-premises, or hybrid if you will and in that context we see the whole pull through. A great example of this is the announcement I made with Golden State Warriors or what we do with the Formula One just to bring it to reality, we provide them the cloud for the factory, we provide them the edge, the circuit and so in other use cases. So it's a big opportunity and it's all driven by this experience you need to provide at the edge and the fact you need to extract value and deliver outcomes from the data that generate at the core. And so, that's why I'm very excited about our strategy.

**Paul Coster**

Are there any special incentives around the data center products inside that Intelligent Edge team?

**Antonio Neri**

Yes, so there is definitely the compensation that the account manager sells everything. They get paid on selling the full-blown solution and then obviously when you bring the specialist their pay on the specific components of it, but the reality, there is cross incentives that go back and forth, but let's be clear, the edge people are just the specialist people. Really the people who bring to bear the solution and the Hybrid IT people sell everything, edge to cloud. And so that's why the strategy's working and more and more pull through for Aruba is happening and the same the other way around because once you have connectivity you have to do some sort of processing of data and that's why we bring the edge compute to bear.

**Andrew Simanek**

Great, thank you, Paul. Next question, please.

**Operator**

Yes, the next question will be from Jim Suva with Citi, please go ahead.

**Jim Suva**

Thank you very much. In your prepared comments, you made a reference to some efforts in China that I believe impacted your margins a little bit. Can you just give us some color on what's going on with your efforts there and the margins and the outlook, especially as it relates to, who

knows what's going to happen with trade wars and stuff, and does this relate at all to H3C which historically we've known or is it something different? Thank you.

**Antonio Neri**

Yes, no, so again, we don't sell directly in China. We actually moved to this new model almost three years ago now and the H3C is the sole distributor of HPE products and they represent us in China, but they are sold as a part of the H3C portfolio and what we are doing like they are doing, is focusing on profitable growth. And so as they focus on the entire portfolio, they pick and choose where they believe is the best thing to do and we are very happy actually, incredibly happy with the performance of H3C because, as you know we collect dividends and they have done really well performance-wise.

**Jim Suva**

Yes, what I was getting was more for forward-looking. Is what you've seen going on, is that something we should expect into 2019 or is it a new change from what we've heard in the past?

**Antonio Neri**

No, I think it continues 2019, and honestly, listen, China's the second largest IT market now. There are a lot of opportunities, but you have to be very focused on where to spend your energy to drive profitable growth, and they are the ones that make those decisions. As you recall, we have actual rights in the governing, because obviously, we are a part of the board, but the reality is that that market will continue to grow. Then, there will be some seasonality, variability quarter to quarter depending on the pipeline, but in the end, we believe China is a great market going forward, and we rely on them and very happy with what they are doing.

**Jim Suva**

And just housekeeping, the tax rate was lower this quarter, and other income was better, how should we think about for 2019, those items?

**Andrew Simanek**

Hi Jim, so I would refer you to what we said at the security analyst meeting. We basically guided other income and expense at a \$250 million expense that includes the equity interest and then if you remember, the tax rate, we basically said from a non-GAAP perspective would be 13%. I would continue to use those going forward.

**Jim Suva**

Thank you so much for the details and clarifications, it's greatly appreciated.

**Andrew Simanek**

Sure, thanks, Jim. Next question, please.

**Operator**

Next question would be from Jeff Kvaal with Nomura Instinet. Please go ahead.

**Jeff Kvaal**

Yes, thank you, gentlemen, for taking the question. I'd like to lead off with an Aruba question. Obviously, that's been a source of great strength, both matched and also some upside. Can you talk a little bit about where you think that strength is coming from? Obviously, there is a decent amount of good IT spending. There's a little bit of a switch refresh under way from your competitors. Does that help and then how much is share gain a factor there? And then, secondly, Tarek, maybe for you, but I think you had mentioned earlier in the script that the FX headwinds

had stiffened a little bit for you over the course of the quarter. That doesn't appear to have changed your guidance at all and I'm wondering if you could talk us through that, please.

**Antonio Neri**

Sure, I will take the first question and then Tarek will take the second one. We continue to see strength in the Aruba business because the reality is the edge is where we live and work and everybody's looking for providing a whole different experience. And the mobile first, cloud first approach that Aruba has is actually resonating with customers and allows them to provide these new experiences whether it's in hospitals venues or retail verticals, they are all looking to provide that connectivity with an application experience that collects data and obviously extracts value out of that data and Aruba is perfectly suited for that because it has a platform-driven approach. And so that drives switching, it drives the new architecture for wireless connectivity with Wi-Fi 6 that's going to be available here soon and obviously the expansion into this IoT-led use cases, for example, smart buildings and so forth. So that's why we are so bullish about that business and then when you bring edge compute to that platform, then you add the incremental capabilities because it is easier to move cloud compute where the data is, not the other way around. So that's what we see and it's all experience-driven and architecture we have actually enabled that.

**Tarek Robbiati**

Yes, and on FX, a good observation, the FX rates have moved somewhat unfavorably relative to the prior month when we were at SAM. When we were at SAM, the Euro was trading at about \$1.15, and now the new spot rates are pointing to \$1.13, trending a little bit lower. So remember, then we said we would face a headwind of one to two points, now it's going to be looking closer to two points for fiscal year 2019. That's what we can say at this stage given where the rates are trending.

**Jeff Kvaal]**

[Multiple speakers].

**Tarek Robbiati**

It can change.

**Jeff Kvaal**

Yes, alright, great, thank you.

**Andrew Simanek**

Thank you. Next question, please.

**Operator**

Next question will be from Rod Hall with Goldman Sachs. Please go ahead.

**Rod Hall**

Yes, hi, guys. Thanks for fitting me in. I just wanted to ask a question about the cash flow. I see that the proceeds from the sale of PP&Es almost more or less doubled in the quarter off of last quarter, and I wonder if you could give us any color on what drove that increase and then I have a follow-up to that.

**Tarek Robbiati**

Yes, that is correct. We did have quite a unique transaction during the course of the quarter. There was a...overall in the year, there's about \$400 million of real estate gains and most of which happened in Q4. We effectively sold the campus that we occupy right now in Palo Alto and we're



moving into a new location during the course of fiscal year 2019, at the beginning of the calendar year of 2019. You'll see all of that explained and disclosed in our 10K for greater details, but that's a one-off. We'll continue to optimize our real estate, but that is quite a unique transaction that has happened in the fourth quarter.

**Rod Hall**

Okay great and then just to follow-up on that, I know that the underlying business there is...or at least a lot of that is the leasing business, and I know some of that is HPQ related leasing and I wondered if you could say, what proportion of that leasing business in the financial services arm is related to HPQ and how much is HPE, I just don't really know the split between the two things.

**Tarek Robbiati**

We don't disclose the split of the receivables in Financial Services between HPE and HPQ, but it has been trending around at the same levels that historical data prior to the split. There hasn't been any major change in that regard, we continue to drive significant growth in volume. We pointed to 8% volume growth in financial services of this year and I'm very pleased with how that is going.

**Rod Hall**

Okay, great. Thank you.

**Andrew Simanek**

Thanks, Rod. I think we've got time for one more question, please.

**Operator**

Alright, and our last question today will be from Amit Daryanani with RBC Capital Markets. Please go ahead.

**Amit Daryanani**

Thanks for squeezing me in guys. The two questions will be one on storage. It was up 13% year-over-year, that's fairly impressive. Can you just talk about what enabled that and how do you think that trends going forward through fiscal 2019? And then secondly on Pointnext, I think it was down 3% year-over-year? How much will it be down? Or what are the extra divestitures or geos that you're exiting from on Pointnext?

**Antonio Neri**

Yes, let me talk about storage first. Listen, I'm very pleased with our performance in fiscal year 2018. We grew 13% for the full year, which is faster than the market, so we expect to gain share in external storage and that's driven by a cohesive strategy with both Nimble and 3PAR enabled by a phenomenal platform called HPE InfoSight which provides predictive analytics for storing and managing that data. And last week, I announced that we're extending that platform now to the rest of the on-premises infrastructure including both compute and networking. So customers see the value of predictive analytics, fix the problems before they happen and obviously now we keep adding features to both the InfoSight and the two platforms both Nimble and 3PAR with the availability of new flash storage and so forth.

If you are the hyperconverge part of that on top of storage, well, actually we'll be growing almost 20%, 19%, and so the combination of different infrastructure for different use cases plus our intellectual property is paying off. And again, we expect that to continue to be the case in 2019 and beyond because we have some exciting solutions that are coming to market, and some of

them we announced it last week at HPE Discover in Madrid. I don't know, Tarek, you want to talk about the Pointnext question?

**Tarek Robbiati**

Yes, if to add a little bit more color on revenue for Pointnext in the quarter, revenue from Operating Services was down 1%. Overall for the full year, it was growing at 2%. Equally orders for the full year were growing at 2% and that was reflected in my script as well.

**Amit Daryanani**

Perfect, thank you.

**Andrew Simanek**

Great, thanks, Amit. I think with that we can close up the call, please.

**CONCLUSION**

**Antonio Neri**

Well, thank you for the time and thank you for the questions. And I just want to wrap by saying I'm very pleased with fiscal year 2018 performance with our growth and expanding profitability and our innovation. I think we made great progress as we transition, and this was all 100% execution driven. 100% of what we did here was about executing our strategy which is clear, and resonating with our customers and partners.

**Operator**

Ladies and gentlemen, this will conclude our call for today. Thank you very much. Have a great day.