Hewlett Packard Enterprise Company

Fourth Quarter 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

Antonio Neri - *President, Chief Executive Officer*

Tarek Robbiati - *Chief Financial Officer*

Andrew Simanek - *Head, Investor Relations*

PRESENTATION

Operator
Good morning, evening and afternoon and welcome to the Fourth Quarter 2019 Hewlett Packard Enterprise Earnings Conference Call. My name is Sean and I'll be your conference moderator for today's call. At this time, all participants will be in a listen-only mode. We will be facilitating a question and answer session 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 go ahead.

Andrew Simanek
Good afternoon. I'm Andy Simanek, head of investor relations for Hewlett-Packard Enterprise. I like to welcome you to our fiscal 2019 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 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 risks, uncertainties and assumptions, please refer to HPE's filings with the SEC, including its most recent Form 10-K and Form 10-Q. HPE assumes no obligations 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-K for the fiscal year ended October 31st, 2019. Also, for financial information that has been expressed on a non-GAAP basis, we have provided reconciliations to the comparable GAAP information on our website.

Please refer to the tables and slide presentation accompanying today's earnings release on our website for details. Throughout this conference call, all revenue growth rates, unless noted otherwise are presented on a year-over-year basis and are adjusted to exclude the impact of currency.

Finally, please note that after Antonio provides his high level remarks, Tarek will be referencing the slides and our earnings presentation throughout his prepared remarks. As mentioned, the earnings presentation can be found 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. Good afternoon and thank you for joining us today. We have just closed a very successful fiscal year 2019 at HPE, marked by strong and consistent performance across the company. We did what we said we would do this year, and built on our track record of delivering on our promises… since I became CEO almost two years ago.

In fiscal year '19, we realized the benefits of a more streamlined and focused company and we executed with discipline. We made organic investments and targeted acquisitions to shift our portfolio to higher-value, higher-margin offerings and we made our culture a priority which has resulted in an 18-point increase in our employee engagement score over the last three years. This re-energized high performing team is committed to accelerating what is next for customers and partners. Through these efforts, we improved profitability across the business and significantly exceeded our original non-GAAP earnings and free cash flow guidance.

Let's take a closer look at our full fiscal year financial results. Revenue has been stable sequentially the last three quarters, with total revenue of $29 billion for fiscal year 2019, down 2% year-over-year when adjusted for tier 1 and currency. Revenue was impacted by our deliberate action to realign our portfolio as we continue to exit the lower margin tier 1 server business, as well as certain macroeconomic factors.

In key areas of strategic investment, we saw strong double-digit growth and reported record revenue for the year in High Performance Compute, HyperConverged Infrastructure and Composable Cloud. We also continued to see very strong growth in HP GreenLake orders. I am pleased to report our first annualized revenue run rate of $462 million consistent with the outlook we provided at our Security Analyst Meeting last month. This metric is to help investors track our progress and better value the recurring and higher margin benefits as we shift our model to "As-a-Service."

Our non-GAAP gross margin of 32.6% improved 270 basis points year-over-year. This is a key metric because it demonstrates our success transition into higher margin and recurring revenue. Our non-GAAP operating profit of $2.8 billion grew 4% year-over-year. We delivered fiscal '19 non-GAAP earnings per share of $1.77, an improvement of 20% year-over-year well above our original and revised guidance.

We improved the quality and quantity of our free cash flow, generating $1.7 billion, which represents growth of 58% year-over-year, even after a $668 million arbitration award payment to DXC.

These strong results allow us to make significant investments in our R&D spending, which was up 10% year-over-year. And as I committed in early 2018, we completed our plan to return $7 billion to shareholders in the form of share repurchases and dividends over fiscal year '18 and fiscal year '19.

Our consistent and strong performance in fiscal year '19 has laid the foundation for the next phase of HPE's journey. HPE is the edge-to-cloud Platform-as-a-Service company, and we will execute our strategic pivot to offering our entire portfolio as a Service by 2022, as we drive sustainable profitable growth.

Before providing an overview of our business segment performance, I want to note that our view on the macro economy has not materially changed. Ongoing global trade tensions and other

geopolitical factors have created uncertainty that contributes to an uneven demand environment.

The elongation of sale cycles we experienced since Q2 continues, particularly in larger deals. But against this backdrop, we are confident we have the right strategy that anticipates our customer needs. We live in an edge-to-cloud world. We have gone from simply having a data center to having centers of data everywhere.

Data has tremendous value and is critical to our customer success. They need a technology partner that has the expertise, the tools and a flexible delivery model to help them harness the power of their data across all their clouds and edges. HPE is uniquely positioned to meet these needs and provide a consistent cloud-like experience for apps and data everywhere.

Our edge-to-cloud platform delivered as a service gives customers the ultimate in choice and flexibility and control to all their apps and data, no matter where they live… so we can deliver outcomes for their businesses.

To highlight the full year performance in our business segments, I will start with Intelligent Edge, which delivered revenue of $2.8 billion, down 2% year-over-year. As we have said previously, we identified some execution issues in North America earlier this year that impacted revenue and we have been actively addressing them through both new leadership and segmentation initiatives. I am particularly pleased with the traction in Aruba Services up 18% in fiscal year '19, which will contribute to driving profitable growth in the future.

Throughout the year, we made substantial R&D and sales investments in our Intelligent Edge business. I am excited about the differentiation we are continuing to build in our portfolio. We developed new products to expand our reach with new customer segments, including the launch of Aruba InstantOn which targets the growing SMB segment, and we made enhancements to Aruba Central which is at the heart of our edge-to-cloud platform. It is the only cloud-native, simple-to-use platform that unifies network management, AI powered inside and IoT device security for wired, wireless and WAN networks.

In Q4, we launched our revolutionary new CX series switching portfolio. This is the industry's first service-rich networking portfolio designed specifically for today's modern enterprise campus, branch and Edge data center. It is cloud ready, easily deployed and simple to manage. This new networking portfolio also lays the intelligent foundation required for future AI-powered automation.

We are seeing traction in the fast growing and competitive WiFi 6 enterprise access point market. In September, industry analysts showed Aruba taking an early market lead position in delivering WiFi 6 infrastructure. Our Aruba 8000 Series core switches that run on our advanced operating system Aruba OS-CX attracted more than 80 new logos per month, and we continue to see new customers turning to Aruba solutions to provide unique and better experiences to their employees and customers at the Edge.

Recent examples include the Kentucky Administrative Office of Courts, who was looking for a solution to manage the evolving demands of a digital workplace in the network of 120 court rooms. Critical to their decision was Aruba Central for its single pane of glass and Aruba ClearPass security to increase visibility and control of the network.

U.S. supermarket chain Giant Eagle selected Aruba switches and the Aruba AirWave Network Management Platform to minimize business latency, optimize operational manageability and roll out services quickly to help the IT staff become more proactive.

And Carnegie Mellon University purchased Aruba Meridian location services platform in conjunction with AppMaker to help them build their smartphone app with wayfinding services. Eventually, this deployment will cover the entire 5 million square foot campus, serving 14,500 students and 3,000 faculty, as well as campus visitors.

More and more enterprises are understanding how critical Intelligent Edge is to their digital transformations. Business outcomes will depend on the experiences they can deliver at the edge. HPE declared the opportunity at the Edge early on, and we continue to make important investments and enhancement to our portfolio and execution to deliver differentiated capabilities and solutions.

Turning to Hybrid IT; our investment in higher-value products and as-a-Service offerings is paying off. Our operating profit of 12.3% for the year was up 210 basis points from fiscal year 2018. Revenue of $22.8 billion was down 3% when adjusted for Tier 1 and currency.

Importantly, we saw strong double-digit performance in key areas of the business. High Performance Compute grew 15% in the full year, Composable Cloud grew 47% and HyperConverged Infrastructure grew 25%. And also this year, HPE Apollo and HPE Synergy each achieved more than a $1 billion in revenue for the first time.

HPE GreenLake continues to be one of our fastest-growing businesses. Orders were up 39% in constant currency in fiscal year 2019. Our ability to deliver a consistent cloud-like experience on- and off-premises, as-a-Service, with HPE GreenLake is a key competitive advantage for HPE. We saw over 200% GreenLake order growth year-over-year in the channel. Our partners are an important extension of our own sales and technical teams, and are a powerful force in driving growth.

At our Security Analyst Meeting last month, I previewed the next generation of our as-a-Service offering. We want to enable our customers to be the broker of services to their enterprise by giving them visibility, access and control across public, private and edge workloads. Stay tuned for a very exciting announcement in early December.

HPE Pointnext services orders, including Nimble orders, grew 1% in fiscal year 2019. Going forward, our favorable shift to higher-value solutions should continue to drive service intensity with higher services attach rates.

In our Composable Cloud portfolio, earlier this month, we integrated HPE Primera, our intelligent storage platform, with HPE Synergy and HPE Composable Rack, accelerating speed and agility to deliver new apps and innovations to propel customers' businesses.

Just last week, we unveiled our new HPE Container Platform. HPE is the first and only vendor to provide a Kubernetes-based container platform that can support the deployment of any enterprise application, whether it was developed as cloud-native or as a virtualized enterprise application. The platform is built on our BlueData container based software platform with a new open-source Kubernetes orchestration engine and integration with MapR's unique file system that can provide persistent data, addressing a key challenge in Kubernetes.

And in our high performance compute business, just last week we announced the industry's most comprehensive HPC and AI portfolio for the Exascale era with the combination of HPE and Cray. We are proud that 21 of the 50 largest systems on the Top 500 Supercomputer List are now HPE and Cray systems.

Against a tougher market backdrop, Storage experienced a modest revenue decline of 2%. However, we continued momentum in key strategic areas. HPE Nimble reported record revenues, up 35% in constant currency for the year.

Finally, no matter what stack our customers choose, we want to differentiate the hybrid cloud experience with the right software-defined innovation tools. Customers are looking for a simplified and automated experience. This is why we took steps to embed HPE InfoSight, our cloud-based AI operations platform, across our workload-optimized portfolio that includes SimpliVity, 3PAR, ProLiant, Synergy and Apollo.

Here are a few examples of how customers are putting our technology to use to drive key business outcomes. Oil and Natural Gas Corporation, a state owned enterprise of India has selected our storage technology paired with HPE GreenLake to help them manage their critical data with consumption-based services. Previously, they have been grappling with rightsizing their infrastructure for unpredictable data growth. However, now as one of our largest HPE GreenLake customers, they will be able to flexibly adjust capacity without overprovisioning.

Since 2017, we have been working with the EPFL Blue Brain Project, a Swiss brain research initiative that is focused on building a biologically detailed digital reconstruction and simulation of the mouse brain. As the Blue Brain Project has progressed in their scientific roadmap and neuroscience research, modeling larger and larger brain regions, they have needed to exponentially increase compute power which they are now doing with a major upgrade of 880 HPE SGI Apollo 8600 nodes.

Turning to HPE Financial Services, fiscal year revenue of $3.6 billion is flat when adjusted for currency, while operating profits increased 70 basis points. HPEFS best-in-class loss ratios drove a strong return on equity of 16%. HPEFS serves as the financial engine behind our as-a-Service offering, giving customers flexibility in how they consume their IT solutions by bringing our robust balance sheet with over $13 billion of net portfolio assets. HPEFS saw strong double-digit growth in its as-a-Service revenue this year.

HPEFS differentiates our value proposition is strategic to our customers as it helps them manage and monetize their existing assets in new ways. HPEFS plays a major role in helping customers achieve their sustainability goals by promoting the circular economy with its best-in-class Asset Management business.

In summary, I am very pleased with our performance in fiscal year 2019. I remain confident in our ability to deliver strong results in fiscal year 2020 as we continue to shift our portfolio to higher value, software-defined solutions and execute our pivot to offering everything as-a-Service by 2022 to deliver our edge-to-cloud platform which will drive sustainable profitable growth.

I'm confident because we have spent the past two years sharpening our focus, never losing sight of our customers and partners and executing with discipline. We've built a world class leadership team that has reinvigorated our culture and is bringing customer-driven innovation to market through our own R&D and through strategic partnerships and acquisitions. We have the

right strategy that will enable us to deliver exceptional edge-to-cloud experiences for our customers that are unmatched in the industry. This is an exciting place to be as we begin the New Year.

With that, I will turn it over to Tarek to walk you through our results in more detail.

Tarek Robbiati
Thank you very much, Antonio. Now let me provide you more detail on our financial results for the quarter and the full year 2019. As I have done before, I'll be referencing the slides from our earnings presentation to better highlight our performance in the fourth quarter and our fiscal year.

Starting with slides one to three, I'd like to first talk about the key highlights for the full year 2019. In fiscal year 2019, we continued to pivot our portfolio towards higher margin and more recurring revenue that will lay the foundation for sustainable, profitable growth in the future. We've executed on our strategy with great discipline and despite an uneven macro environment, we maintained sequentially stable revenue for the last three quarters. And we did this while significantly expanding non-GAAP gross margins which improved by 270 basis points this year, driven primarily by structural improvements including product mix and cost of sales efficiencies.

Our gross margin improvements have enabled us to make further investments in the business, while simultaneously delivering growth in non-GAAP operating profit. The combination of margin expansion and below the line benefits including share buybacks resulted in diluted non-GAAP EPS of $1.77 which is up 20% year-over-year and well above our original outlook of $1.51 to $1.61 provided at SAM in October 2018.

On the cash front, we generated significantly higher levels of free cash flow this fiscal year of $1.7 billion which was up 58% compared to the prior year. I'll talk more about that later in the presentation.

On the acquisition front, we successfully closed the Cray transaction in September well ahead of schedule. While the financial impacts of Cray were minimal in fiscal year 2019, we expect to derive more material benefits in fiscal year 2020 and beyond.

Finally, we also delivered on our capital returns program commitment over fiscal year 2018 and 2019 returning $7 billion to shareholders in the form of share repurchases and dividends per our original commitment made in early 2018.

Now turning to slide four for the quarterly results. We finished the quarter with non-GAAP diluted net EPS of $0.49, which was above our previously provided outlook of $0.43 to $0.47 and up 14% from the prior year. GAAP diluted net EPS for the quarter was $0.36 above the previously provided outlook of $0.24 to $0.28 primarily due to the benefits from the termination of the tax matter agreement with HP, Inc. that was established at the time of the separation.

Moving on to a macro view of the business on slide five. As Antonio mentioned, our view of the macroeconomic environment remains largely unchanged with uneven demand. Trade tensions and geopolitical factors continue to cause business uncertainty, particularly in larger enterprise deals similar to what we called out during the prior two quarters. However, HPE's broad

portfolio and global footprint makes us well diversified to handle choppy markets which has enabled us to stabilize revenue in the last three quarters.

We will now move to slide six that shows our performance in the quarter by segment. I won't take you through every number, but let me hit a few key points. In Intelligent Edge, we've made sales leadership changes and introduced new segmentation to improve our go-to-market execution. We believe the Edge remains the next big opportunity, which is why we've continued to make significant R&D and sales investments, despite pressuring near term profitability. We now have an enhanced go-to-market and a full suite of differentiated solutions that can also be consumed as a service. Going forward, we are expecting a meaningful improvement in profitability as these investments begin yielding benefits and revenue returns to growth as fiscal year 2020 progresses.

In Hybrid IT, we continue to grow our higher margin Compute offerings with Composable Cloud growing at 21%, reaching a record level of $1 billion in annual revenues this year and our Apollo offerings which power the high performance compute portfolio also reaching a record $1 billion in annual revenues. These organically developed offerings demonstrate the strength of our innovation engine.

With respect to units, excluding Tier 1 and China, our server units have been growing sequentially since Q2 of fiscal year 2019 and were up year-over-year. Within Storage, we continued making great strides in the entry level and mid-range storage markets with notable strength in Nimble Storage which grew 2%. HyperConverged Infrastructure, which will be reported in Storage starting the next quarter, grew at 14%.

In our Services business, Pointnext Operational Services orders, including Nimble orders, were flat this quarter, but up 1% on a full year basis in constant currency. Our services intensity which is the ratio of attach revenue per unit was up across all hardware categories this quarter. Services intensity reached record levels in Value compute and Storage, which were both up over 20% year-over-year. This demonstrates that the underlying profitability of the units we sell and the attach rates continue to improve.

GreenLake orders, which have 100% services attach rates, grew by an impressive 72% year-over-year to record levels demonstrating strong execution in pivoting to our as-a-Service offerings.

Within HPE Financial Services, we expanded our net portfolio of assets which was up 1% in constant currency this quarter, with longer contract term supporting GreenLake and we maintained a strong return on equity which exceeded 15% again this quarter.

And while not shown on the slide, Communications and Media Solutions or CMS is a strategically important business providing software capabilities to telcos, which is showing improved momentum. Orders in CMS were up 17% year-over-year due to improved execution selling software licenses. We are excited about the opportunity for CMS to collaborate across all businesses, to capitalize on 5G momentum and the growth opportunity with service providers.

Slide seven shows our EPS performance to-date. Non-GAAP diluted net earnings per share of $0.49 in Q4 is well above our previously provided outlook of $0.43 to $0.47 due to operational outperformance and favorable other income and expense. This marks the 10th quarter in a row that we have exceeded the high end of our non-GAAP quarterly outlook.

As a reminder, we ended fiscal year 2017 with a non-GAAP EPS from continuing operations of $0.94. Based on our fiscal year 2019 diluted non-GAAP EPS performance of $1.77, we have demonstrated tremendous progress in non-GAAP EPS which has grown by over 88% in the last two years. We have been able to achieve this through significant expansion of gross margin and operating margins which I will talk about next.

Turning to gross margins on slide eight, we continue to deliver significant year-over-year gross margin expansion as we focus on profitable growth in Hybrid IT, shifting our portfolio towards higher value, higher gross margin offerings and more recent commodity tailwinds.

Non-GAAP gross margins of 33.3% was up 260 basis points year-over-year and up 500 basis points since Q1 of fiscal year 2018. This has been possible through a combination of portfolio mix shift, HPE Next initiatives and commodity tailwinds.

Now moving to slide nine, we continue to make significant investments in R&D and sales to support future revenue growth, while driving significant non-GAAP operating margin expansion. HPE Next has enabled us to redirect investments back into the business including a double-digit increase this year in R&D to drive organic innovation in our higher margin, faster growth areas of the portfolio and additional investments in go-to market through improved sales effectiveness. We expect to drive revenue productivity and growth in the upcoming quarters from these strategic investments. Meanwhile, non-GAAP operating margin has climbed over 10%, up 290 basis points versus Q1 2018.

Turning to cash flow on slide 10, free cash flow was seasonally very strong at $878 million in Q4. On a full year basis we generated significantly higher levels of free cash flow of $1.7 billion that is up over $600 million or 58% versus the prior year driven primarily by higher profitability and lower HPE Next payments. Underpinning our year-to-date free cash flow performance is an improvement of over $1 billion or 35% in our cash flow from operations relative to last year.

It is important to note that in the $1.7 billion figure, we absorbed the unexpected arbitration payment of $668 million made to DXC. We also had a $200 million benefit from terminating the Tax Matter Agreement with HP, Inc. Most importantly, even without the payment from HP, Inc., we would have been at the midpoint of our original FY '19 guide of $1.4 billion to $1.6 billion.

Looking forward into fiscal year '20, it is important to consider some puts and takes as you model out free cash flow. We expect cash earnings will increase with growing profitability and we expect to receive another tranche of $50 million from HP, Inc. related to the termination of the Tax Matters Agreement.

We will also need to make capital investments in our as-a-Service offerings and make integration payments related to Cray that will drive future revenue and profit growth. As a result, we continue to expect fiscal year 2020 free cash flow to be between $1.9 billion and $2.1 billion.

Slide 11 shows the ARR slide I had discussed at our recent Securities Analyst Meeting. Please reference the SAM presentation for a deep dive into what makes up the ARR. Our Q4 2019 ARR actuals came in line with our guidance at SAM at $462 million. Looking forward, we feel confident we can achieve our growth guidance of 30% to 40% compounded annual growth rate from fiscal year 2019 to fiscal year 2022.

Slide 12, shows our capital returns to-date. We returned $431 million to shareholders during the quarter. We paid $147 million in dividends and repurchased $284 million worth of shares in the quarter. At this point, we have completed our $7 billion capital returns program over fiscal year 2018 and fiscal year 2019, returning $4.1 billion in fiscal year 2018 and $2.9 billion in fiscal year 2019. It is also important to note that we have also recently raised our dividend payment from $0.1125 per share to $0.12 per share, an increase of 7%.

Now turning to our outlook on slide 13. At our recent Securities Analyst Meeting, we provided our outlook for fiscal year 2020; I would encourage you to review my presentation for a more detailed discussion of that outlook. Having said that let me reiterate a few key points of our outlook.

From a topline perspective, we expect to grow our fiscal year 2020 revenue adjusted for currency fluctuations. Also we expect to grow our fiscal year 2020 non-GAAP operating profit by 4% to 6%. Consequently, we expect fiscal year 2020 non-GAAP diluted net earnings per share to be a $1.78 to $1.94 and fiscal year 2020 GAAP diluted net earnings per share to be a $1.01 to $1.17. For Q1, 2020, we expect GAAP diluted EPS of $0.20 to $0.24 per share and non-GAAP diluted net EPS of $0.42 to $0.46 per share.

So overall, I'm very pleased with the performance in the quarter and the fiscal year 2019. We have successfully demonstrated that our business is resilient to macro softness and can generate substantial amounts of free cash flow. We have the right strategy and have laid a strong foundation for the years to come.

We will continue to shift our portfolio to higher-margin, software-defined solutions and will focus on delivering our edge-to-cloud platform, offering our full portfolio as a service by 2022. This will ultimately drive sustainable profitable growth and shareholder returns for the long-term.

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

QUESTION AND ANSWER

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

Our first question today will come from Katy Huberty with Morgan Stanley. Please go ahead.

Katy Huberty
Thank you. Good afternoon. As we look into the January quarter, do you have any thoughts around the revenue trajectory, just looking at Street expectations for a revenue increase of 2% to 3% from the October quarter, but since the spin from HP, there isn't a consistent seasonality and in fact, revenues have been flat to down in past January quarters?

Tarek Robbiati
Hi, Katy. Good afternoon. It's Tarek here. So as a broad reminder on fiscal year 2020, we do expect to grow revenue adjusted for currency overall. Now when you specifically get into the Q1 of fiscal year 2020, you have two effects to take into consideration. Number one, the reality that we're operating in is different than the one it was in fiscal year 2018, owing to the macro

environment. And number two, we will consolidate the contribution of revenue from Cray in full for the first quarter. So on the whole, we do expect within the context of what I mentioned and with seasonality that we'll grow revenue for the full year, and on a first quarter basis we'll be roughly flat sequentially relative to where we stand right now.

Katy Huberty
Okay, that's helpful. And Tarek, how should we think about the contribution from lower commodity costs on gross margin of the 260 basis point gross margin expansion? How much of that would you say is from commodity costs? Thank you.

Tarek Robbiati
Yes. So far, as we explained at SAM and even in prior earnings releases, some of the gross margin expansion is structural in nature as a result of the products and the mix of what we sell, and the remainder is driven by commodities. So I would say 50:50 is the rough split between what is structural and mix related on one side, versus commodities on the other. We feel that the commodities environment is probably at the best it could be right now, and it's going to continue for a little bit. The question is how long will that be continuing for. We do believe that the profitability levels that we are experiencing right now are here to stay for at least a couple of quarters.

Antonio Neri
And I will say Katy, couple of things. One thing I am pleased with is our discipline with pricing. I think the team has done a very good job despite the changes in commodity price… and to drive the right configuration for the right workloads and the right pricing… which as you can see we have achieved what I believe is a record year of profitability in Hybrid IT business. But as we talked before, the structural changes continue to be there because obviously the systems with more IP, built particularly with software-defined, as well as, the configuration for density and more data-driven type of configurations, give us the confidence on that AUP stability as we go along.

Andrew Simanek
Great. Thank you, Katy, appreciated. Can we go to the next question, please?

Operator
Our next question will come from Tony Sacconaghi with Bernstein. Please go ahead.

Tony Sacconaghi
Yes, thank you. I was wondering if you could just comment on the demand in macro environment, I know you used the term stable a lot in terms of revenue stability. But if we look at the metrics that you like to use most which is…I think the most accurate which is ex-tier 1 at constant currency, it's gone from plus 1 in Q2 to minus 3 in Q3 to minus 7 in Q4, and the comparisons are really not all that different and if anything you had a bit of Cray this quarter? And so, at least on the surface, it appears as though the macro environment might be becoming more challenging and you've had a number of other enterprise players suggest that. So perhaps you can provide us with an update on the macro environment, and if you do believe it's relatively stable then why are we seeing this deceleration in revenue trajectory? And I have a follow-up, please.

Antonio Neri
Sure. Thanks, Tony for the question. As I said, our macro economy view has not changed…materially changed from Q2, since we started talking about this, but I will say, Tony there has been two halves here. The first half, obviously coming in from a strong 2018 with inflationary commodity costs, obviously Tarek can talk a little bit more about the tax reform and what that did and in some pent-up demand on some modernization that needs to take place because of digital transformation.

And then the second half, more driven by the tariff situation with the global trade, some geopolitical instability and then the deflationary side of the commodities. We saw unit increase in Q4 of 2%. So I think… you know… the elongated sales cycles continue to be there. We believe the demand is there. It's just a matter of timing in many ways, and obviously, customers are looking at where to spend the dollars. And I would say a lot of dollars are spent to make sure they can harness the power of the data as fast as possible because that's the value of doing this. But obviously if we stay in this environment, there will be always a little bit more questions out there. So hopefully, we're going to get the result one way or the other way. But I am still very hopeful about the future because obviously this digital transformation continues to be there and continue to accelerate, and data continues to explode around us. So now Tarek, you have any additional comment on that?

Tarek Robbiati
Yes. Thank you, Antonio. I'd like to add some comments on the impact that tax reform has had on the industry. We've done a fair bit of work on this internally and there is no doubt that fiscal year 2018 was propelled by the benefits from tax reform… i.e. there was more disposable income for large corporates worldwide to be spent on infrastructure and that has happened… that carried on pretty nicely all the way on to the first quarter of fiscal year 2019. Beyond that point, there was a drop due to macroeconomic factors, but also we do believe that there is an element where the spend that was taking place in fiscal year 2019 has to be digested by the companies moving forward. So in simple terms, I'd say the tide has come down in fiscal year 2019 relative to fiscal year 2018 and that digestion is taking place.

So year-over-year compares, which give rise to the calculations you've put forward, Tony… by the way… your calculations are correct. The year-over-year compares are lesser and less relevant in the context where you do have to assume that this infrastructure is to be digested. And what's important for us is to see that the revenue remaining stable should bode well for the future, as continuous demand for data will get to a point where that capacity that has been essentially consumed in fiscal year 2018 will need to be refreshed in the upcoming quarters. So hopefully that provides you with color on the year-over-year compares.

Antonio Neri
And I will say, Tony, one more thing is that our revenue for the last three quarter has been stable. So despite all of this, our revenue have been stable for three consecutive quarters.

Tony Sacconaghi
Thank you for that. I know you've made some very conscious decisions about exiting Tier 1 and focusing on higher value products. But just on a reported basis, your revenue is down $1.7 billion or about 6%, and so the question is, in light of a smaller topline,, do you have to take out incremental costs because you have a lower revenue base and how do we think about that? Is HPE Next all done or is there more? Do you feel you need to take out more cost and certainly at least in this quarter, you seem to have very tight control over OPEX even R&D, which have been growing all year seem to have come down this quarter, despite Cray? So maybe you can

comment on, in light of a top line albeit somewhat driven by your own decisions being down, whether you need to take out incremental cost and how specifically you're thinking about OPEX and whether Q4 was really a sign of what we should expect going forward?

Tarek Robbiati
Sure. So like Antonio said, Tony, the revenue for us was stable hovering above the $7.2 billion mark for Q2, Q3 and Q4. What's interesting in this is the underlying profitability of the revenue has materially improved as a result of some actions that we have taken shifting the mixed structural improvements in the products, et cetera.

So the underlying EPS and you could see it also from an operating cash flow standpoint has been improving materially, although the revenue is stable. So EPS for Q2, we were at $0.42, for Q3, we were at $0.45 and for Q4 we were at $0.49. So we are extracting more and more value over a revenue base that is stable. In saying that, we are not going to cut costs materially to propel our EPS forward in fiscal year 2020. The reason is, we do believe that we have to continue to make investments in R&D in the key strategic areas of our business, the Edge being one of them... the second one Storage. And you'll see more and more of that in the upcoming quarters.

There is always an element of having to apply cost discipline and that is normal in the context of any company and should be expected. We feel that it's important that we stay relatively nimble in our thinking and not inflate our cost base too much. But the underlying fundamental trends of data are there and they're playing out. That's why we are investing quite significant amounts of dollars in R&D in the right category. And the performance of our Edge business this year… if you really look at it and what has driven it in the detail… a lot of the underlying operating profit performance is driven by those R&D and FSC investments that we made to pivot the business to growth in the upcoming quarters.

Antonio Neri
So Tony, I will add a couple of things. First of all, if you're asking the question will there be a separate cost reduction program again? No, we are executing our HPE Next. This is the year three, and we are super, super pleased with the outcome and we expect to continue to derive productivity from what we have done in the previous two years. Understand there is one more year to go here, which will complete the program.

But as Tarek said, we will always look for opportunities to improve the productivity of the business by improving the way we engage customers and partners, and obviously we still need to get a lot of the benefits of the investment we've made in IT. This year, we invested plus 10% when you look at the year as a whole, plus 10% growth in R&D and FSC, and that will also drive productivity in term of growth in the key strategic areas that we're looking for. So we are very proud and pleased with the work we have done and I think we have still a disciplined mentality here to continue to be very, very rigorous about our approach. But I want to make clear that there is no one-off program here… we already have done what we needed to do and that becomes now part of the DNA of the company going forward.

Tony Sacconaghi
Thank you.

Andrew Simanek
Great. Thanks, Tony. Can we go to the next question, please?

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

Shannon Cross
Thank you. Can you provide more details on the performance in Storage this quarter? If you can talk pricing and demand competition… just wondering what the underlying trends you're seeing there are. And I have a follow-up. Thank you.

Tarek Robbiati
Sure. I mean, Storage was down year-over-year, 11%. But when you look at the year, Shannon, it was down 2%, within that, we saw growth in HyperConverged, which is up 25% for the year and we saw Nimble set a record year of 35%. And we are leveraging now the platform called HPE InfoSight, which you're familiar with… our AI ops platform… that we embedded everywhere… whether it is in ProLiant or whether it is in our Storage business across the entire portfolio beyond Nimble. So we have now HyperConverged. We leverage it in HPE Primera. Primera for us will be an area of growth going forward. But if you look at the last point of market share, we actually gained 100 basis points in market share last quarter. So in a market, obviously, there has been a kind-of stop in the growth in the second half, and probably decline. And while we don't have the final figures here, we gained share. So that's why we are very excited about our Storage portfolio and obviously it's a key strategic area for us.

And then with the acquisition of MapR and BlueData storage, now we have a complete portfolio for our customers in the software defined space and that's why we introduced our HP Container Platform last week. So for the year again, the revenue was down 2%, but in that a lot of growth was in key strategic areas and profit improvements… and share gain in the last quarter that was reported.

Antonio Neri
And specifically for Storage Shannon, if I may add, Storage revenue in Q4 relative to Q3 was marginally up on a sequential basis. This is again another element of the prior answer which is year-over-year compares are of a different nature, given the various effects at play nowadays, but revenue from Storage, sequentially Q4 on Q3 was marginally up.

Shannon Cross
And pricing, what trends are you seeing there? Given what's going on in commodities?

Tarek Robbiati
I think I would say, pricing on Storage is stable.

Shannon Cross
Okay. Thanks. And then my final question or my second question is just on China. Can you touch on what you're seeing through the joint venture and what that market looks like and maybe some of the trends in terms of using your technology versus H3C's? Thank you.

Antonio Neri
Yes. So our set up in China continued to be a point of focus for us. We are pleased with that set up because obviously it allows us to participate in a market that is unique. The indigenous part of the H3C in China continues to grow nicely and obviously we capture that through our dividends.

And our portfolio, meaning the HP side of portfolio, continue to be sold through that entity because they are the exclusive distributor of products in China, but that has been declining because of the shift between the indigenous products and HP-owned products. So overall, in total that business continues to grow, but as always, there are challenges there driven by the same situation we see here. But overall, we are very pleased with the set up and I think it's the right set up at this point in time today, considering the global trade tensions.

Tarek Robbiati
Great. Thank you, Shannon. Could we go to the next question please?

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

Simon Leopold
Great. Thanks for taking the question. I want to see if we could maybe double click on what's happening trend wise in the Intelligent Edge, the HPE Aruba business in that. I think earlier this year, you had talked about some execution issues that's hampering this business, and now, I guess, we've got some concern about the macro, yet some opportunities from things like Wi-Fi 6. Just if you could maybe walk us through the cross currents and how to think about the trajectory of that line of business? Thank you.

Antonio Neri
Sure. First of all, I am excited about the business because it is positioned for where we see the trends in the market, right. So first of all, the digital transformation starts by providing secure connectivity to drive the experiences through the digital transformation.

Second, more and more workloads are moving to the edge. And so we have been working on a couple of things. First, our portfolio of products – we have the best portfolio we had now with the introduction at HP Discover and later in Q3 with Aruba Central, which is the most comprehensive as-a-Service model for both mid-market and enterprise… and Aruba InstantOn, which is a killer solution for the SMB market. Obviously, WiFi6 became available in the second half of 2019.

And as I said in my earlier comments, more than one-third of the WiFi6 and Enterprise was Aruba, but it is early stages. Obviously, we had to work on our own execution in North America, which we feel we have put behind us and we feel that that's going to give us momentum as we enter 2020. But in the Aruba portfolio, obviously we sell Aruba and the rest of the portfolio and I will say that the Aruba parts of the portfolio is steady and growing slightly and the other ones are slightly down, but in aggregate, that's where you see the performance. So I know Tarek has few comments to add with that.

Tarek Robbiati
Yes. Thank you, Antonio. So I found the Intelligent Edge, if you look at our presentation and you referred specifically to slide three. You will observe that the majority of the operating profit decline is driven by the conscious decision we made to invest in R&D products to equip the Edge with a full suite of products. So more than two-thirds of the operating profit decline year-over-year is a conscious decision we've made to invest in R&D to equip Aruba with a full suite of products and very recently they've launched a number of different solutions including a single operating system to cater for the high end of the market all the way down to branches, Wi-Fi 6, Aruba Central. And we feel that now the company is from a portfolio standpoint…product portfolio standpoint, extremely well positioned for the future. It's been acknowledged by number

of industry analysts, publications, including the Gartner Group, IDC and Forrester Research and we feel that we are extremely well-equipped and positioned for the future with Aruba. Now this puts more emphasis obviously on execution in fiscal year 2020 and we look forward to seeing the fruits of those investments.

Simon Leopold
Thank you.

Andrew Simanek
Great. Thanks, Simon. Can we get our next question, please?

Operator
Our next question will come from Rod Hall with Goldman Sachs. Please go ahead.

Rod Hall
Yes. Hi guys, thanks for the question. I wanted to start by asking if you've seen any change in the size of customers exhibiting these delays and lower spending patterns, in other words, have you seen it moved from Fortune 100 type customers down to mid markets in any of your business line or in all of them. And then I have a follow-up to that.

Antonio Neri
No, not really, I mean what we said is that the elongation in sales cycles are really in the mostly in the enterprise space in the larger deals, not in the smaller deals or smaller customer segments.

Rod Hall
Okay, great. Thanks, Antonio. And then the follow-up, I wanted to see maybe Tarek, if you can answer this. Would the potential transaction at HPQ change their commitment to you in terms of financial services in any way or whatever commitment they have with you persist through any sort of potential transaction?

Tarek Robbiati
The simple answer to your question is no. There is a contract in place between the parties. We've been working for decades with HPI on financing their own equipment. This is incredibly well established and set across the channels. It's incredibly difficult to therefore dislodge HPFS from those channels. We feel very good about this. I don't think a transaction will cause us any palpitations in that regard.

Rod Hall
Okay, great.

Antonio Neri
Because of the market we cover, and the vast majority of those customers or channel partners, we have direct relationships anyway.

Rod Hall
Okay, excellent. Thank you.

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

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

Jim Suva
Thanks. I have two questions and I'll ask them at the same time. So you can decide which to ask first…answer first or second. So the first one is your sales growth, you mentioned growth for next year, is that with or without Cray? I know you said on a currency as adjusted basis, but I want to be clear is that with or without Cray? And then my second question is your fiscal 2020 EPS outlook is the same from your Investor Day. Does that include more stock buyback and if so, how much should we plan on? Thank you.

Antonio Neri
The first question is with Cray, which is what we said at the Security Analyst Meeting, and Tarek will answer the question on EPS.

Tarek Robbiati
So yes remember, at our Securities Analyst meeting, we said that we would be from a capital management policy return between 50% to 75% of our cash flow to shareholders. And therefore, that this would be tracking cash flow, which in turn will be tracking earnings and there is no change to this. We've assumed a certain level of share buybacks, which is what is currently implied by the market and the dividend we upped the dividend from $0.1125 to $0.12, so you can very easily do the math to understand the level of share buyback that is implied by the figures, I've just quoted to you.

Jim Suva
Thank you so much for the details. That's greatly appreciated.

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

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

Aaron Rakers
Yes. Thanks for taking the question. I have one question and a follow-up as well. As we think about the impacts of component pricing dynamics and it sounds like the positive trends might continue here for a little bit with regard to the business in the gross margin. I'm just curious, is there any kind of framework you can help us understand… of how much mix has played a part within the server category, particularly any comments on how much content growth you've seen from say DRAM or memory, in general. Just trying to think about the structural kind of sustainability of those trends going forward.

Tarek Robbiati
Okay. So you may recall from my speech that I made a comment with respect to units, and we explained that when you look at the units of what we sell excluding Tier 1s and China, our server units have been growing sequentially since the second quarter of fiscal year 2019, and they were up 2% year-over-year in Q4 with higher services intensity. So this is really the key driver of our earnings performance in Q3 and Q4, and we see those trends continue, although now most of what we sell is Gen10 on the server side. We do believe that the configurations

that customers require to cater for the exponential growth of data are closing ultimately to see units going up and eventually AUP after phase of deceleration will start to go up again. So that's what we are seeing in the medium to long-term.

Antonio Neri
Obviously, we have taken actions ourselves to take advantage of the supply, pricing, and as you know, we do a lot of long-term supply arrangements as they become available. But in the end, it's the structure of the systems, particularly as the Generation 11 comes online, that will drive again another structural change in our AUPs because of the configurations.

Aaron Rakers
That's helpful. And then as a second follow-up question. On the Storage business as we think about the product portfolio, I know you mentioned strong growth in Nimble, but I'm just curious of where we're at with the Primera product? When do we expect that to really start to materialize from a revenue standpoint? And just remind us how much of your business in Storage is related to more of those higher end platforms? I think that that's founded on the legacy 3PAR platform. I'm just trying to think about the refresh opportunity as you look through this next several quarters what that might present?

Antonio Neri
Yes, we have received very strong accolades and interest on HP Primera, and remember HP Primera, we don't sell it just as a part of our independent storage appliance, but we sell it as a part of a Composable Cloud. And with integration, with both HP Synergy and HP Composable rack as a block of IT that has all the software defined intelligent and automation, including HP InfoSight. And obviously our strength has been mostly in the mid-range market and…but the high-end is very…is a market that's very interesting for us and we are rolling that as we speak, and I believe throughout 2020, will be a driving force for growth for us. Generally, the market is actually moving in a direction that's more software-defined, and that's why HP InfoSight is a key component of HP Primera for us, because it's mostly a software-on-appliance-based driven solution. But it is actually the software that makes that unique.

Aaron Rakers
Thank you very much.

Andrew Simanek
Great. Thank you, Aaron. So I think we're unfortunately out of time for questions. But, Antonio, let me turn it over to you for any final comments.

CONCLUSION

Antonio Neri
Well, as always thank you for joining us today. I just wanted to wrap up by saying I believe we had another very strong year. This is the second year as a CEO and we did what we said we would do. I think we have achieved record level of profitability, non-GAAP EPS and free cash flow. I will emphasize the free cash flow because we actually improved cash flow by 58%. We are on track to deliver that normalized cash flow. We have spoken many, many times and we are very, very confident that $1.9 [billion] to $2.1 billion. What I'm really pleased about is the execution in the business… our discipline by pivoting the business… and excited about the future without forgetting the fact that the culture of the company plays a huge role and I couldn't be more pleased and proud of the work we have done here. So thanks again for joining us today and hopefully see you soon.

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