Hewlett Packard Enterprise

Fourth Quarter 2020 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 - *Vice President of Investor Relations*

PRESENTATION

Operator
Good day and welcome to the Fourth Quarter 2020 Hewlett Packard Enterprise Earnings Conference Call. My name is Cole, and I will 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 star key followed by zero. And as a reminder this conference call is being recorded for replay purposes.

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

Andrew Simanek
Great. Thanks, Cole. Good afternoon, everyone. I am Andy Simanek, Head Investor Relations for Hewlett Packard Enterprise. I'd like to welcome you to our fiscal 2020 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 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-K, for the fiscal year ended October 31, 2020. 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 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 is also embedded within the webcast player for this earnings call.

With that, let me turn it over to Antonio.

Antonio Neri
Well, thanks, Andy, and good afternoon everyone. Thank you for joining us today and I hope everyone is staying safe and healthy.

Hewlett Packard Enterprise finished the year with a very strong performance. In Q4, we saw a notable rebound in our overall revenue, with particular acceleration in key growth areas of our business.

As we reviewed at the last month's Securities Analyst Meeting, we are focused on a set of strategic priorities to drive long term sustainable profitable growth and accelerating sustainable profitable growth. This includes stabilization of our core businesses, doubling down in areas of growth and accelerating our pivot to as-a-service, while taking decisive action to strengthen our financial foundation and become a more agile company. We executed with precision on these strategic priorities, and I'm proud of the results in what has been a very challenging fiscal year '20.

Let me review a few Q4 highlights. First, our total revenue of $7.2 billion returned to pre-pandemic levels, up 5% sequentially and flat on a year-over-year basis. We saw increased new orders momentum across all business segments of our company. As I stated in our Q3 earnings, we expect continued gradual performance improvement moving forward. As expected, we returned our backlog to normalized levels this quarter.

In Compute, revenue declined 7% sequentially, but was up low single digits when normalized for backlog over the last two quarters. We are encouraged by new orders intake that point to stabilization in this business, taking into account the typical Q1 seasonality. Most importantly, if you look at the combined server view across Compute and HPC/MCS businesses, which is how the market tracks server performance, our total net revenue in the server market would be up 3% sequentially and up 1% year-over-year. As a result, we believe we gained share in total Servers for the second consecutive quarter.

In Storage, revenue grew 7% sequentially to $1.2 billion. We also expanded our operating profit to 16.7%, an improvement of 380 basis points sequentially and within the target profitability range of 16% to 18% we discussed at SAM. In both Compute and Storage, we drove higher levels of operational services intensity consistent with prior quarter performances.

In Q4, we accelerated our business performance in key growth businesses. In Intelligent Edge, revenue rebounded to $786 million, up 14% sequentially and 5% year-over-year. This business performed exceptionally well against the market backdrop. High Performance Compute and Mission Critical Systems had an outstanding quarter, recording revenue of $975 million. This business grew 50% sequentially and 25% year-over-year.

Our pivot to as-a-service continued its strong momentum. Our annualized revenue run rate of $585 million was up 11% sequentially and 30% year-over-year. The on-premises as-a-service market is growing rapidly, especially in a hybrid environment and remains a significant long-term value driver for us and our shareholders.

Through strong operational execution, we delivered non-GAAP earnings per share of $0.37, up 16% sequentially and above the high end of our guidance. Free cash flow of $223 million was in line with our Q3 and SAM guidance. Additionally, we declared our Q1 dividend today, which will be paid on January 6th.

As we have said in the past, dividends remain an important part of our capital allocation framework that consists of capital returns to shareholders and strategic investments that together drive long term shareholder value.

Based on the strong finish to FY20 and increased confidence in profitability going into Q1, we are raising our FY21 non-GAAP EPS guidance by $0.03 at the midpoint. Tarek will review our financial performance and outlook in greater detail, but I will first provide some context around our execution and customer reactions to our approach and offerings.

The global pandemic has forced businesses to rethink everything for remote work and collaboration to business continuity and data insight. Over the last several months, we have seen growing momentum in our businesses as customers increasingly turn to HPE for capabilities from edge to cloud.

Our unique set of capabilities help our customers empower their work forces, deploy new resilient IT solutions and extra insights from critical data while leveraging and consuming these solutions more flexibly as-a-service. We continue to strengthen our core businesses in Compute and Storage which provide critical capabilities to customers and are foundational to our edge-to-cloud platform as-a-service strategy.

In Compute, the team did an outstanding job of driving supply chain efficiencies and clearing historical levels of backlog. We will continue our focus on streamlining processes to enhance productivity in this high-volume business.

We are a market leader in Compute and we are being deliberate in our focus on gaining market share in profitable market segments. This quarter, we became the first company to embed silicon-based security into our industry standard servers being manufactured through our HPE trusted supply chain in United States. This security is critical to a growing number of US customers across federal, public banking and finance and healthcare verticals. We also launched a new HPE inference solution on HPE ProLiant servers in conjunction with Red Hat and NVIDIA to accelerate machine learning directed at the AI and containers markets.

In Storage, we have been on a multi-year journey to create an intelligent data platform from edge to cloud and pivot to software as-a-service data storage solutions, which enable higher level of operational services attach and margin expansion. And, our strategy is gaining traction. Our portfolio is well positioned in high-growth areas like All Flash Array, which grew 29% y/y, Big Data Storage, which had its sixth consecutive quarter of growth up 41% y/y, and Hyperconverged Infrastructure, where Nimble dHCI, our new hyperconverged solution, continued momentum and gained market share, growing 280% year over year.

We also committed to doubling down in growth businesses and invest into fuel future growth. The Intelligent Edge is a critical segment where we declared the opportunity early on and are increasingly differentiated. At the edge, customers need secure seamless connectivity to bridge the digital and physical worlds and the ability to generate actionable analytics where the data is created. This is why Aruba is seeing traction and gaining market share with its leading and highly differentiated portfolio of solutions such as our cloud-native Aruba Edge services platform, which also contributes to ARR growth.

For example, the Pentagon is modernizing both its classified and unclassified networks to support tens of thousands of devices daily using Aruba's ESP-based architecture. Comcast also chose our Aruba ESP to power its new Comcast Business Teleworker VPN. The service supports and secures multiple end points in a remote work site, including laptops, desktops, voice-over IP phones and printers, and partners can centrally manage remote workers and all its infrastructure from a single Aruba ESP cloud console.

This quarter, we expect to take share in both campus switching and WLAN with our best-in-class portfolio, which was just recognized as a leader for the 15th year in the Gartner Magic Quadrant for wired and WLAN access infrastructure.

Finally, toward the end of Q4, we closed the acquisition of Silver Peak which will accelerate Aruba's SD-WAN growth in an attractive market growing over 20%, and enable our edge-to-cloud platform as a service vision.

Silver Peak brings industry-leading technology and was named a leader in the Gartner 2020 Magic Quadrant for WAN Edge Magic Infrastructure. We believe the explosion of devices, applications and data at the edge will continue to drive demand for secure connectivity, cloud computing capabilities and analytics, especially in a post-COVID world.

Another high growth segment where we are extremely well positioned is in high-performance computing. In Q4, we performed exceptionally well across the portfolio with growth in Cray products, mission critical systems, operational support services and HPE Apollo. The team did an outstanding job in converting the existing backlog and new orders to drive a record quarter breaking nearly $1 billion of revenue. Q4 marked our first full quarter of Cray operational activity integrated into HPE systems, and the combination of Cray and HPE is driving increased revenue and cost synergies.

We signed several large customer deals during the quarter, including pre-exascale system design wins that will use the HPE Cray EX supercomputers. These wins include a $34 million contract with the Pawsey Supercomputing Centre in Australia and a $160 million contract with the European High-Performance Joint Undertaking initiative to deliver one of the world's fastest supercomputers that will be used by 10 European countries. We extended our number one market position in HPC with 37% market share as of calendar Q2 data, which is 10 points above the next closest competitor. According to the list of the Top 500 supercomputers released two weeks ago, HPE and Cray systems make up 39 of the Top 100 systems, more than any other company.

In addition, our HPE Apollo systems had its highest revenue quarter ever. As an example of the traction we are seeing with Apollo...with our Apollo value proposition, Mercedes-Benz Grand Prix constructor of the Mercedes-AMG Petronas Formula One Team signed a deal for the new Apollo system.

Modeling and simulations are about gaining a competitive advantage on the track and our HPE technology is critical to this team's race strategy. Going forward, we are working to bring high-performance computing power to everyday enterprise environments. Stay tuned for more announcement on this front in the coming few weeks.

Consumption-based solutions provide an attractive alternative for customers looking to drive innovation and modernize infrastructure without the capital and operational expenses tied to over provisioning. We are a leader in on-premises as-a-service and have been investing in our HPE software platform and HPE GreenLake managed services offerings to enable a true consumption-based experience that is unique. Customers are recognizing our differentiated products and services which can be seen in our as-a-service orders growth of 20% year-over-year.

This quarter, we continued to expand our offerings and introduced HPE GreenLake VDI cloud services. Building on the success of our ready-to-go virtual desktop infrastructure solutions

launched early in the year to help customers with immediate connectivity needs, this new solution provides configurations that are optimized for each type of remote worker. Customers can easily scale usage up or down, which is a compelling and critical capability in today's environment. By leveraging expanded partnerships with Citrix, Nutanix, NVIDIA, VMware and Wipro, we can offer comprehensive solutions to an expanded customer base.

Our advanced capabilities are driving strong customer demand across diverse markets and industries. We recently announced several new customers. Nokia Software is using HPE GreenLake cloud services to embed further cost and energy savings into its data storage portfolio.

Microgen, a leading precision medicine and biotechnology company selected HPE GreenLake to modernize its IT operations to analyze large scale medical data on-premises. YF Life Insurance, a fast-growing Fintech company based in Hong Kong also selected HPE GreenLake to strengthen its online sales platform, applications and Fintech support systems.

The momentum we are realizing in each of these areas is possible because of our focused strategy and disciplined execution. By innovating and investing in the most impactful areas and optimizing how we manage our own business, we are ensuring we are in the best possible position to help our customers manage theirs.

Early in the pandemic, we recognized there was no going back to what it used to be -- only preparing for and building what comes next. This is one of the reasons we have made the recent decision to relocate HPE's headquarters to Houston. We have listened to our team members' preferences about the future of work and reimagined our real estate site to optimize and improve how both physical and virtual office spaces are used in this new era.

Houston has long been HPE's largest U.S. employment hub, and we are currently constructing a state-of-the-art new campus. Obviously, we intend to maintain our innovation tech hub in San Jose, California. Our Aruba headquarters will be housed within our digitally enabled San Jose site, so storage and software. There will be no layoffs associated with this move and consolidation. We are committed to both markets as critical parts of our talent and real estate strategy in a post pandemic world.

As we have been transforming how we work, we have also recognized that we have an enormous opportunity for customers, transform and digitize their business to adapt and operate in a new world. Business continuity and success depend on solutions that advance IT resiliency, empower remote workforces, securely extend connectivity, reinvigorate customer engagement and enable business model evolution. Against this backdrop, HPE has delivered despite the challenging circumstances. We have brought new capabilities and experiences to our customers to meet their emerging needs.

We have invested in both organic innovation and M&A that strengthen and differentiate our position in the market. We have acted quickly to protect our financial foundation and become a more agile company and we have remained committed to our culture. We have asked a lot of our team this year and I am personally immensely proud and grateful for the significant courageous contributions.

There is no question, there is more work to be done, but our customers have validated our vision and we have demonstrated in Q4 and throughout 2020 that we have the right team and the right strategies in place to execute on that vision. While there remains continued uncertainty in the world, there is also a great deal of promise and optimism. The HPE we created five years ago

has an important role to play in the world's recovery from an unprecedented pandemic. That presents an opportunity for our company and for our investors. I'm confident we will continue to rise the occasion and deliver in bold new ways.

With that, let me turn it over to Tarek to review the quarter's results.

Tarek Robbiati
Thank you very much, Antonio. I'll start with a summary of our financial results for the fourth quarter of fiscal year 2020. As usual, I'll be referencing the slides from our earnings presentation to highlight our performance in the quarter.

Antonio discussed the key highlights for this quarter on slide four. So now, let me discuss our financial performance starting with slide five. I am very pleased to report that Q4 marked a return of revenue to pre-pandemic levels. We delivered Q4 revenues of $7.2 billion, up 5% sequentially and flat from a prior year period, as our growth businesses of Intelligent Edge and HPC/MCS executed strongly.

We also cleared our backlog by a further $250 million during the quarter, which has now returned to normalized levels as we exited Q4. As a result of the improved revenue performance, we have grown non-GAAP gross profit by 7% sequentially to $2.2 billion in Q4. Non-GAAP gross margins of 30.6% were also up sequentially driven by positive mix shift towards Intelligent Edge, Storage and HPC/MCS, all of which reported strong sequential revenue growth.

Our non-GAAP operating profit was up 15% sequentially, resulting in a 7.7% operating margin and our non-GAAP EPS of $0.37 was up 16% sequentially. Q4 cash flow from operations was $747 million, driven by strong operational execution. Free cash flow was $223 million and that was in line with our guidance as we saw the expected reversal in the favorable working capital movements from elevated backlog in Q3. Finally, we paid $154 million of dividends in the quarter and are declaring a Q1 dividend today of $0.12 per share payable in January 2021.

Now, let's turn to our segment highlights in slides six and seven. As you can see, we are doing exactly what we said we would do at SAM in October. We are doubling down on our growth businesses of Intelligent Edge and HPC/MCS while stabilizing our core business segments of Compute and Storage.

In Intelligent Edge, we continued our momentum with 14% quarter-over-quarter and 5% year-over-year growth. We also expect to take share in both campus switching and wireless LAN with our best-in-class portfolio, which was just recognized as a leader for the 15th year in the Gartner Magic Quadrant for Wired and Wireless LAN Access Infrastructure. We are also beginning to see the operating profit potential of this business with operating margin in Q4 of 10.1%, up 150 basis points quarter-over-quarter and 390 basis points year-over-year as we drove greater productivity from prior investments in this business.

Finally, we closed the Silver Peak acquisition on September 21st, so it had a minimal contribution in Q4, but obviously Silver Peak will be more meaningful going forward.

In HPC & MCS, revenue reached record levels near $1 billion, growing 50% sequentially and 25% year-over-year, driven by strong performance in Cray, HPC Apollo and MCS. We executed well against our existing order book with increased customer acceptances and grew orders further with a healthy pipeline. As you know, this business can be lumpy with revenue recognition and profitability linked to completion of critical customer milestones. While we do expect to see a

normal seasonal decline in Q1 ’21, we are well on our way to delivering our 8% to 12% three-year revenue CAGR outlined at SAM.

In Compute, revenue declined 7% sequentially but was up low single digits when normalizing Q3 and Q4 results or backlog conversion. Gross and operating margins were also pressured by clearing the backlog as we had to fulfill orders at cost levels higher than originally quoted. We are pleased to report that backlog has now returned to normalized levels, thanks to continued improvements in our supply chain execution.

Within Storage, we grew revenue 7% quarter-over-quarter driven by strong operational execution, reduced backlog and improved order momentum in key areas of the portfolio. We saw notable strength in big data, up 27% sequentially driven by increased customer focus on AI machine learning related applications, all-flash array storage up 19% sequentially by increased…driven by increased adoption of Primera all-flash and dHCI which grew double digits sequentially. We also expanded operating margins this quarter, which was up 380 basis points quarter-on-quarter, ending at 16.7% of revenue and already aligned to our SAM fiscal year ’23 targets.

With respect to Pointnext Operational Services which is included across our Compute, HPC/MCS and Storage segments, total revenue was up 2% while orders were down 1% on a sequential basis. Additionally, our services intensity, which is the ratio of attach revenue per hardware units sold continued to be strong with notable strength in Compute and Storage, excluding Nimble which were up low single-digits growth on a sequential basis.

In Advisory & Professional Services, revenue was up 6% sequentially, even as COVID impacted consulting activity and the chargeability levels of our staff. Within HPE Financial Services, financing volume was up 6% and revenue was up 2% quarter-over-quarter, despite the impact of COVID-19. We maintained a solid return on equity of approximately 13% this quarter. Our bad debt loss ratio this quarter was 1.06%, which while slightly higher than previous quarters, is still best-in-class and well within our comfort zone as cash collections have already returned back to pre-COVID levels.

In our Communications and Media Solutions business that is included in our Corporate Investments segments, orders were up 18% and revenue was up 6% sequentially driven by strong double-digit orders and revenue growth in Americas. Additionally, due to our improved cost of delivery, we were able to expand operating margins by 240 basis points quarter-over-quarter. We continue to make good progress in our 5G core strategy that provides multi-vendor integration and true cloud-native telco network functions.

Slide eight, shows key metrics of our growing as-a-service business, which I elaborated on during our recent Securities Analyst Meeting. We’re making great strides in our aaS offering. I am pleased to report that our Q4 ’20 ARR came in at $585 million, representing 11% quarter-over-quarter and 30% year-over-year reported growth. Total as-a-service orders were up 20% year-over-year driven by outstanding performance in North America and APJ.

Our HPE Aruba Central SaaS platform also continued to grow revenues strong double-digits year-over-year. Based on strong customer demand and recent wins, I am very happy with how this business is delivering and progressing towards its ARR growth targets of 30% to 40% CAGR from fiscal year ’20 to fiscal year ’23, set at our 2019 SAM and reiterated at our 2020 SAM meeting.

Slide nine, highlights our revenue and EPS performance to-date, where you can clearly see Q2 was a trough. Strong operational execution has driven sequential revenue growth from a low of $6 billion in Q2, all the way back to $7.2 billion in Q4.

Turning to slide ten, the rebound in revenue has resulted in a 15% improvement in non-GAAP gross profit from the Q2 trough, which was up to $2.2 billion in Q4. Also, the gross margin rate in Q4 of 30.6% of revenues was up 20 basis points sequentially, driven by a higher mix of Intelligent Edge, Storage and HPC/MCS which are higher margin businesses, offset by continued execution of elevated Compute backlog, which was a headwind, but is now behind us.

Moving to slide 11, you can see how the improvement in gross profit combined with progress on our cost optimization plan has delivered 53% growth in operating profit from the Q2 trough, while still investing for growth. As mentioned at SAM, we are making excellent progress in our cost optimization and prioritization plan which will strengthen our financial foundation while aligning resources to critical growth areas.

As of the end of this quarter, we are on track to deliver annualized net run rate savings for at least $800 million from the FY ’19 baseline by the end of fiscal year ’22, with most of the savings being realized by the end of fiscal year ’21. Obviously, we will keep you updated on our progress in the upcoming quarters.

Turning to slide 12, we generated cash flow from operations of $747 million and free cash flow was $223 million for the quarter, driven by timing of working capital movements from clearing backlog that resulted in favorability in Q3, but a headwind we flagged for in Q4. We ended fiscal year ’20 with free cash flow of $560 million in line with our outlook provided at SAM 2020. Looking to ’21, we expect free cash flow to grow over 75% at the midpoint of our outlook of $900 million to $1.1 billion. Please remember our normal cash flow seasonality where the second half is a stronger generator of cash flow than the first half.

Now, moving on to slide 13, let me remind everyone about the strength of our diversified balance sheet and liquidity position, which is a competitive advantage in the current environment.

As our October 31 quarter end, we had approximately $4.2 billion of cash after successfully redeeming $3 billion of bonds maturing in October 2020 and paying approximately $853 million net of cash for closing the Silver Peak transaction. Together, with an undrawn revolving credit facility of $4.75 billion at our disposal, we currently have approximately $9 billion of liquidity.

Finally, I would like to reiterate that we remain committed to maintaining our investment grade credit rating, which was recently reaffirmed by the rating agencies. Bottom line, we have a strong cash position and ample liquidity available to run our operation, continue to invest in our business and execute on our strategy.

Now, turning to outlook on slide 14. At our recent Securities Analyst Meeting, we provided our outlook for fiscal year ’21, and I would encourage you to review my presentation for a more detailed discussion of that outlook.

Having said that, let me drill down on a few key areas. We continue to expect to grow our fiscal year ’21 non-GAAP operating profit by 15% to 20%, and now expect FY '21 non-GAAP diluted net earnings per share to be between $1.60 to $1.78 as a result of increased confidence in margin improvement. This is a $0.03 per share improvement on the midpoint of our prior guidance of $1.56 to $1.76 in EPS.

From a top line perspective, we are pleased with the rebound we saw in Q4 and continue to see gradual improvement, but want to remain somewhat cautious due to the uncertain pace of recovery from the COVID-19 pandemic. More specifically for Q1 ’21, after normalizing for excess backlog reduction in Q4 ’20 of $250 million, we expect Q1 ’21 revenue to be in line with our normal sequential seasonality of down mid single-digits from Q4. For fiscal year ’21, we expect total revenue to be in line with our long-term financial targets of a CAGR of 1% to 3% presented in our recent Securities Analyst Meeting. For Q1 ’21, we expect GAAP diluted net EPS of $0.02 to $0.06 and non-GAAP diluted net EPS of $0.40 to $0.44.

So overall, I’m very pleased with the performance in the quarter and execution against our strategy and financial priorities outlined at SAM. We have navigated well through unprecedented challenges this fiscal year and had a very strong finish. Q4 was marked by a strong rebound in revenue as we reduced backlog to normalized levels and saw increased order momentum across all business segments. We saw significant acceleration and customer demand in our growth businesses of Intelligent Edge and HPC/MCS.

Our core business of Compute and Storage is pointing to signs of stabilization and our as-a-service ARR continues to show strong momentum aligned to our outlook. We have been proactive in strengthening our financial foundation and aligning resources to critical areas to transform our core. This will ultimately drive sustainable profitable growth and shareholder returns for the long run.

Let me close by reiterating that I’m very proud of what we have accomplished as a team during very challenging and uncertain times and we look forward to fiscal year 2021.

Now with that, let’s open it up for questions. Thank you.

QUESTION AND ANSWER

Operator
We will now begin the question and answer session. To ask a question you may press star then one on your touchtone telephone. If you are using a speakerphone, please pick up your handset before pressing the keys, to withdraw your question, please press star then two. We also request that you only ask one question.

And our first question today will come from Aaron Rakers with Wells Fargo. Please go ahead.

Aaron Rakers
Yes, thanks for taking the question. I guess, I wanted to go into the Compute segment a little bit more. First of all, can you talk a little bit about the demand linearity you saw throughout this October quarter? And just as we move forward, how do I think about the operating profitability? If I look back in fiscal ’19, I think the average operating margin was somewhere in 11.5% range. This quarter it was 6%, averaging about 7% this last fiscal year. I’m just trying to understand what is the kind of normalized operating margin profile of that Compute business. Thank you.

Antonio Neri
Alright. Tarek?

Tarek Robbiati

Alright. Look, if you look at total revenue in Compute, as Antonio said and I think I reiterated too, revenue was up low single digits when you normalize for Q3 and Q4 for backlog conversion, right. Considering where we were at the end of Q2, the team did an outstanding job of driving supply chain efficiencies and clearing that backlog. The backlog is no more a problem. It's back to normalized levels.

Specifically, with respect to order trends and momentum, order trends were encouraging and then this is pointing to further stabilization in this business. And most importantly, if you look on a combined view for servers across Compute and HPC & MCS which is how the market tracks servers' performance, our total net revenue in the servers would be up low single-digit sequentially and up low double-digit sequentially if you exclude the impact of backlog in Q3 and Q4.

We feel we gained revenue market share in total servers for the second consecutive quarter. Now, when you look at margins in that context, gross and operating margins were pressurized by clearing backlog as we had to fulfill orders in Q4 at cost levels higher than they were originally quoted. Having said that, we are pleased to report now again that the backlog has returned to normalized levels and we continue to improve our supply chain execution. As we continue to stabilize this business, we expect gross margins to expand now that backlog is no longer an issue and mix shift to more profitable market segments. We also continue to optimize R&D and sales investments and expect to achieve an operating profit margin of 10% to 12%. This is what we told you as part of our long-term outlook provided at SAM.

Antonio Neri
I just want to emphasize a couple of points that I hope that...it didn't get lost through Tarek's commentary here because he provided a lot of insight. Our orders in Compute without China because as you know we have a different setup in China, it was up 2% quarter-over-quarter, our new orders. And then, as we think about the total server category, which is Compute plus HPC plus MCS, you combine all of that and basically when you normalize for the backlog, we would have been up quite a bit sequentially and up low single-digits year-over-year and that's why we believe we have gained share in total server revenue.

Andrew Simanek
Great. Thanks for the question, Aaron. Operator, can we go to the next one, please?

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

Simon Leopold
Thanks for taking the question. I wanted to see if you could drill down on what's occurring in the Intelligent Edge business. In particular, we see a couple of crosscurrents, maybe macro recovery would be helpful, but this could be offset by increased work from home. There's this debate about how this business may trend and on top of that, I have the impression that you expect to gain market share from some of your larger competitors. I wonder if you could help us understand how you weigh these various crosscurrents when you look out over calendar 2021 opportunities for the Intelligent Edge. Thank you.

Antonio Neri
Yes, thank you for the question. We committed to doubling down on the edge two years ago where I went on to state that the Intelligent Edge is the next big frontier and when you think about digital transformation, all starts with a connectivity, and in order to participate in the digital transformation, you need connectivity, you need security and then ultimately you need to bring

the cloud computing, where the data is created and we have now seen that the vast majority of the data is created outside the data center, outside the big cloud, and more and more where we live and work. Obviously, the pandemic has validated what I said two years ago that the enterprise of the future will be edge-centric, cloud-enabled, and data-driven. And when I think about our Q4 performance and I'm going to speak organically because the Silver Peak acquisition was just four weeks, five weeks in our numbers, we grew year-over-year versus our competitors in the traditional space whether it's Cisco or others declined and that's why we believe we are going to gain share.

And the reason why we believe the momentum will continue is not just because of the transformation that we see in customers, particularly as we are going to be in a much more distributed enterprise where connectivity has to be ubiquitous, it's because we have a cloud-native solution. It is important that the street understands our Aruba Edge services platform is a software company and provides cloud connectivity from the cloud with security, analytics, AI and all the things that you need in this environment and massive scale and it has been designed for devices, people, and things and that's why we have in that platform today more than 65,000 customers, and we are adding 14,000 new devices every single day and that momentum is all about the experience we can provide. And this is why we saw the 14% growth sequentially and also, we saw the 5% year-over-year growth, but what is interesting is it is a software-as-a-service growth because ultimately that contributes to our ARR. And by the way, our switching was up sequentially high single-digits versus our competitor down and our wireless line was up 20% quarter-over-quarter. We believe we have something especially unique here, right at the middle where the customer demand is. I don't know, Tarek, if you want to add any commentary.

Tarek Robbiati
That's absolutely right, Antonio. There's one thing I can add from a financial standpoint is we do project that the edge is going to outgrow the market given the strong differentiation that the Aruba Edge services platform provides as Antonio described and we see revenue growing at a 6% to 10% CAGR over the next three years from FY '20 to FY '23 and this will come with enhanced profitability. We ended Q4 with a 10.1% OP margin, up 150 basis points. Longer term, we expect operating margins to progress upwards through the teens with more scale and richer gross margins from higher software content such as the Aruba services platform, including the contribution from Silver Peak.

Antonio Neri
And I think you should walk away with three key trends, so that you can put that in context. One is, Wi-Fi for secured remote worker solutions. Wi-Fi 6 refresh, which is a pull-through for switching because of the architecture and obviously the acceleration for SD-WAN which obviously Silver Peak plays a huge role. And last but not least, we see an increased demand in NaaS which is network-as-a-service, which obviously is a component of our HPE GreenLake offering.

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

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

Wamsi Mohan
Hi, yes. Thank you. Congrats on the strong execution and solid quarter. Antonio, you're back at pre-pandemic revenue levels for overall revenue and your growth segments are performing impressively. Do you see this as a sign that enterprise spending is coming back stronger than

you thought 90 days ago? And Tarek, if I could, can you just give us an update on the roughly $2 billion of payments that are potentially coming your way from Oracle and how you would deploy that if you got that over the next year? Thank you.

Antonio Neri
Yeah, thanks, Wamsi. I mean I will say we are very encouraged by the order momentum we have. Obviously, there's still quite a bit of uncertainty out there. We still subscribe to our thesis that Tarek and I discussed in Q2 which is a U-shaped recovery. But what I am really pleased is that all of the momentum and the sequential growth that we continue to see and the demand particularly in the growth areas, but also very pleased with what is pointed to the stabilization of the core business. You know the fact that our Compute orders grew sequentially 2% is very, very good. We also saw sequential growth in Storage in orders. And I think it's pointed to different solutions, Wamsi. You know, obviously, we see in our containers, we see bare metal applications, we see everything that's workload optimized. Data recovery is one aspect of it. VDI is another aspect of it. I think there is a shift in not just buying infrastructure, but that type of infrastructure which is way more optimized and one of the things we see obviously is GreenLake.

GreenLake is a driving force for pulling through our portfolio and when you pull that portfolio through, Compute and Storage win and that's where we discussed at SAM, not only we need to focus on the stabilization, but the transformation of that business to become more software and silicon oriented which, you know, the exact example of that is we introduced our Silicon Root of Trust Version 2.0, which is the most secure platform on the planet. But what is interesting, if you listen to some of our competitors, including today, they say that 96% of the spend is still on-prem. This is not my words. It's a big cloud provider who said that and that transition is an important transition for us to capture and that's where we went ahead with our on-premise solutions as-a-service. So, that's where I think there is definitely stabilization in demand. There is increased demand in certain areas associated with connectivity, AI, data. We see more workload optimized solution. We see more IT resiliency needed at this point in time. And that's where, you know, as we enter Q1, we enter with a very strong momentum on orders and that's where we were confident with Tarek to raise our guidance for the year. Oracle?

Tarek Robbiati
Wamsi, the question on Oracle, yes, we have not forgotten about that one, of course. Let me remind everybody where we stand. There was a $3 billion roughly jury verdict in HPE's favor in the Itanium matter. That matter remains on appeal. The renewed judgment now stands at $3.8 billion in total with interest accruing at 10% since May 2019, an interesting interest rate here. The appeal has been fully briefed and we are awaiting the California Court of Appeal to schedule oral arguments. Although, we are hopeful that we will receive a ruling from the California Court of Appeal in 2021, obviously, the timing of this is out of our control. We remain confident that the outcome on appeal will be favorable to HPE and also, I want to remind you all that we would have to share any sort of payment with our cousins at HP Inc.

Antonio Neri
Correct. Thanks, Wamsi.

Andrew Simanek
Great. Yes, take the next one. Can we go to the next question please?

Operator
Your next question will come from Amit Daryanani with Evercore ISI. Please go ahead.

Irvin Liu
Hi, thanks. This is Irvin Liu dialing in for Amit. I wanted to get an update on your HPC & MCS business. During your recent Analyst Day, you alluded to this business in addition to Intelligent Edge being contributors to growth, and clearly, this quarter puts an emphasis on that viewpoint. Can you perhaps highlight some of the underlying demand vectors for a business that's been historically lumpy in nature? Perhaps the durability of this level of growth looking forward and perhaps progress on reaching customers beyond Cray's historically public sector customer base? Thanks.

Antonio Neri
Yes. Well, that's part of the thesis why we combine Cray with the organic portfolio HPE had. You know, you need to look at the segmentation of the business. Obviously, Cray plays on the top end of the supercomputer market with a unique set of technologies both in software and silicon. That's very important to understand. Cray brought to us a fully verticalized stack from the silicon, particularly in the interconnect fabric to the entire software to manage these very specialized workloads which is a significant point of differentiation for us. And then the HPE Apollo which is a platform I actually introduced when I was running the Compute business in 2013 plays more in the mid-range and the low end in a density-optimized and other types of workloads. The combination drives tremendous synergies across the entire segment.

And you know, it's true it is lumpy. No question about it, but it's lumpy because the way the mechanics works in term of revenue recognition. In this business, obviously, you take the order then you have the time to build it. It takes sometimes months to build one of the systems. You have to ship it, you have to install it, you have to run the workload and only when the customer gives us the acceptance, we can recognize revenue. But remember, what we showed you at SAM is the fact that we have more than $2 billion in backlog, meaning awarded business that we expect to ship between '21 and '22, and that business is already won, okay.

And some of those include exascale systems, which obviously we shared the data with you which we won five out of six. But since SAM, we won new deals and I quoted some of those in my opening remarks, like the Pawsey deal and the European Union deal and these are typical. And the reason why we win is because we have a very set of specialized technology and the need to collocate data in Compute is unique and that's why not only we continue to grow the business at the pace you saw, but also we own 39 of the Top 500 supercomputers and we own 37% of the share. We are very pleased with this business. Our thesis is coming through, and the reason is because of data. Data is exploding. AI is now a democratized tool in many ways. You need high-performance computing capabilities to run it. And by the way, we see now the momentum on margins too, right, because now we own more of that stack.

Andrew Simanek
Great, thanks, Irvin. Appreciate the question. Operator, next one, please?

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

Shannon Cross
Thank you very much. I was wondering, Antonio, if you can talk a bit about your thoughts behind the headquarters move and any potential cost savings not from layoffs, but perhaps lower taxes in that? And then, I don't know, Tarek, if you can just confirm that the cost of the new building was included within your free cash flow estimates? Thank you.

Antonio Neri
Sure. Listen, as we look into the future, our business needs opportunities for cost savings, simplifying our footprint and also remember we learned quite a bit, Shannon, about the team preferences about the future to work. Altogether, we made the decision to relocate the headquarters. Let me be clear. Our technological hub for innovation, particularly in Aruba, software, storage is in Silicon Valley. And basically, what we are doing is consolidating our Silicon Valley footprint in the state to our San Jose headquarters that we opened last year. This is our technological hub. Now, for non-technical hub and jobs, we decided to move the headquarters to Texas, because you have access to diverse talent and ability to attract and retain is unique and differentiated.

What we are creating here is two very strong hubs with clear mandates on each of them. From the taxes perspective, there is none, because we are incorporated in Delaware to begin with. Definitely our savings are associated with the real estate because as you rationalize the Bay Area footprint, you expect savings. The cost of that new site in Houston was already included in our numbers because we already were building that since beginning of 2020. That was already in the plan. We are not changing anything. We're just relocating that and what we are doing for the unique job functions that we believe are better suited to be in Houston, we are offering the voluntary move to the employees and there will be no jobs impact in California. That's pretty much it. And we are creating, again, two very strong hubs for our company and rationalize the footprint that will drive cost savings over time, which by the way they're part of project accelerate as we go along.

Shannon Cross
Great, thank you.

Andrew Simanek
Great. Thank you, Shannon. Operator, next question, please?

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

Katy Huberty
Thanks, good afternoon. What have you seen in Europe as markets...as some of those markets have shut down and do you view that as a path to what you might see in the U.S. over the next few months. And then just as it relates to demand in the October quarter, any difference in trends between the commercial enterprise and public sector?

Antonio Neri
Yes, Katy. I mean, Europe was strong for us. I mean, honestly, the lockdown is happening as we speak maybe in the last two weeks to three weeks in some markets, but I have to say, no real impact at this point in time that we can see. We again exit October with the momentum and a good order book getting to Q1. The momentum is being cut in November, but again there's still a lot of uncertainties out there. I'm not sure yet what real impact it is. Also, we'll say that customers are now kind of accustomed to deal with this way to work. Obviously, we have been now nine months, 10 months in this situation and so business continues. There may be...certain things may be slowed down over time because you need to access the certain facilities. But overall, I haven't seen anything in particular right now. Commercial seems to be improving. And then, on the public sector side, obviously, we participate in particular with HPC and that continues to be very, very strong, I will say.

Andrew Simanek
Great thanks, Katy. Operator, next question, please?

Operator
And our next question will come from Jeriel Ong with Deutsche Bank. Please go ahead.

Jeriel Ong
Thank you so much for squeezing me in. Revenues, it's nice to see this revenue trend kind of get back to that flat year-on-year range, but if I really look at the gross and operating margins, there's still deltas on a year-on-year basis. I understand the normalization of backlog may have something to do with the modeling of this, but I guess going forward as you...with your forecasting of fiscal 21, what are the prospects for margin normalization back into those fiscal 2019 figures? Thanks.

Tarek Robbiati
Hi, Jeriel. Thanks for the question. If you refer back to our outlook on revenue that we provided at SAM and that was a 1% to 3% CAGR growth of revenue that we reiterated today as we issued our guidance for fiscal year '21. We also said that we expect operating profit to grow 15% to 20% over next year. And, when you take the combination of the revenue growth, which is outpaced by the operating profit growth, yes, surely there will be operating margin expansion, and what's fueling that expansion is the cost optimization and prioritization program, which is well on track and most of the benefits of that program will be attained towards the end of fiscal year '21. And I want to remind everybody that we are foreseeing $800 million of net run rate savings of the fiscal year '19 baseline and so you can infer from this where the margins would be by the end of fiscal year '21 leading into fiscal year '22.

Andrew Simanek
Perfect. Thanks, Jeriel. Operator, I think we've got time for just one last question, please.

Operator
And that question will come from Rod Hall with Goldman Sachs. Please go ahead.

Rod Hall
Yes, thanks for fitting me in. I wanted to come back to the Financial Services business and particularly the write-off percentage and the increase there. I know there's a little bit of seasonality there, Tarek, but it seems like that's up a little bit. I'm just curious if you could say a word about...I know you've said it's a healthy absolute level, but a word about what it tells us about the end market and whether you would expect that to decline in the January quarter? And then, I assume the return on equity there is still relatively low because you guys are forgetting payments, but could you just update us on that payment forgiveness plan and is that over? You're still doing it? Just kind of give us an update on where that stands as well. Thanks.

Tarek Robbiati
Thank you, Rod. It's a really good question. When you look at the Financial Services business, the bad debt loss ratio is just over 1%. It's up modestly. I'm very comfortable personally with that level, given what happened in the pandemic and we are absolutely satisfied with the way the business unit has performed. The team has worked incredibly hard to give payment holidays to certain customers who needed it. This is why year-over-year, you see the revenue dropping, but the profitability hasn't dropped dramatically at all and that is testament of the way the management team has performed this year and it's actually what that translates into is an extremely strong

position for the future because what happened is that you had contract extended as a result of those "payment holidays" and when those contracts extend that over time leads to higher returns as you know in the leasing space. On the whole, I feel very, very positive about the performance of HPEFS. We want to reiterate cash collections have already returned to pre-COVID levels, which is good. Economically, it's a sound position also for the economy. We're now collecting cash on deferrals granted earlier in the year and that level of deferral was granted to a small subset of the customers and we do expect the return on equity to trend back to the 15% plus levels over the next couple of years.

Antonio Neri
All right, thanks, Tarek. I know there may be some more questions, Andy, but I know you and Tarek will do some callbacks as well. And, there will be opportunity for those who were not able to put a question in to answer the question. In any case, I just want to finish by saying that Q4 was marked by a very strong rebound in our total company revenue. We are pleased with the results. While much uncertainty still exists in the overall market, I am confident in our team's ability to execute, the strategic priorities we shared with you, particularly at SAM, which we believe will position us to drive future sustainable profitable growth. And again, thank you for joining the call today...joining us today on the call and I hope you continue to stay safe and healthy. Happy holidays to you and your families.

CONCLUSION

Operator
Ladies and gentlemen, this concludes our call for today. Thank you and at this time you may now disconnect.