

Hewlett Packard Enterprise Company

Fourth Quarter Fiscal 2022 Earnings Conference Call

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CORPORATE PARTICIPANTS

Antonio Neri - *President, Chief Executive Officer*

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

Jeff Kvaal - *Vice President, Investor Relations*

PRESENTATION

Operator

Good day, and welcome to the Fourth Quarter Fiscal 2022 Hewlett Packard Enterprise Earnings Conference Call. My name is Chuck 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 call is being recorded for replay purposes.

I would now like to turn the presentation over to your host for today's call, Mr. Jeff Kvaal, Vice President of Investor Relations. Please go ahead, sir.

Jeff Kvaal

Good afternoon and thank you Chuck. I'm Jeff Kvaal, Head of Investor Relations for Hewlett Packard Enterprise. I'd like to welcome you to our fiscal 2022 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 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 release on our HPE Investor Relations webpage at investors.hpe.com. 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 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, 2022. 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 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, after Antonio provides his high-level remarks, Tarek will be referencing the slides and our earnings presentation throughout his prepared remarks. The earnings presentation is also embedded within the webcast player on our website for this earnings call.

And with that, let me turn it over to you, Antonio.

Antonio Neri

Well, thank you, Jeff, and good afternoon and thank you for joining our call today. HPE had an impressive fourth quarter, delivering outstanding performance across our key performance metrics.

Q4 was HPE's most profitable quarter on a non-GAAP continuing operations basis since 2017, with our second highest quarterly revenue and record quarterly free cash flow. In 2018, we introduced a clear strategy to deliver sustainable long-term value for shareholders. And in 2019, we began our pivot to prioritize recurring revenue through our HPE GreenLake edge-to-cloud platform. We have refocused our portfolio and our customer value proposition to a high growth and higher gross margin solutions. We also improved our operating leverage across the company. We are now seeing these strategic actions paying off.

In Q4, orders remained steady, showing continued interest in our differentiated edge-to-cloud solutions across industries from enterprises, large and small. Demand over the course of the year was enduring and proved to be better than we anticipated. We closed this fiscal year with a significantly larger order book that we had at the start of the year. I am very proud of our performance in the quarter and in fiscal year 2022. Faced with ongoing macroeconomic challenges, supply constraints and adverse foreign exchange, HPE executed exceptionally well.

During the fourth quarter, total HPE revenue climbed 4% year-over-year on a constant currency basis to almost \$8 billion, which was above our sequential outlook as we started to see a slight improvement to ongoing supply constraints.

Our Compute and Intelligent Edge businesses had particularly strong revenue growth, each rising more than 20%. Even on these higher revenue base, we grew our non-GAAP operating margin. Non-GAAP operating margin rose to 11.5%, up 180 basis points year-over-year, one of the highest quarterly levels in HPE's history. Non-GAAP gross margin was just above 33%, a 10 basis points improvement year-over-year, reflecting ongoing pricing discipline.

As customers continue to turn to our edge-to-cloud solutions, we saw increased demand for our HPE GreenLake platform. Annualized revenue run rate rose 25% year-over-year even with supply constraints as a headwind. Total as-a-service orders again increased more than 30% from a year ago, helping us close the fiscal year with the as-a-service order growth of 68%. In the final quarter of the fiscal year as-a-service orders represented approximately 12% of the total company bookings.

Non-GAAP profit in the quarter was a standout. We achieved record quarterly profit, despite the continued unfavorable effects from foreign exchange. Our non-GAAP diluted net earnings per share was \$0.57, a 90% sequential rise and 10% increase year-over-year.

Free cash flow in the final quarter was just shy of \$2 billion, our best ever for a quarter. Free cash flow improved in the second half of the fiscal year 2022, as expected, following better supply chain conversion [indiscernible] and working capital actions as we took to increase cash flow from operations.

As we look at our full fiscal year '22 performance, it is clear the HPE GreenLake platform has enhanced our financial profile with more resilient, recurring revenue. Our portfolio is steadily becoming richer in software and services. We continue to shift our next to higher growth markets and more IP rich offerings. And we continue to invest in our go-to-market capabilities that are solution-led and outcome-based. Since we began our as-a-service pivot in 2019, our AIR has more than doubled to \$963 million. We exited fiscal year 2022 with more than \$8.3 billion in HPE GreenLake total contract value, more than twice what it was just two years ago.

In fiscal year 2022, we produced \$28.5 billion of revenue, 5% higher compared to 2021, and above the 3% to 4% outlook we provided at Securities Analysts Meeting 2021. We achieved

this revenue despite not yet having booked all revenue from our Frontier exascale system, which was delayed because our customer needed to extend the acceptance timeframe.

Through a combination of pricing actions, portfolio mix shift and cost discipline, we sustained our margins in fiscal year 2022, even in the face of supply constraints, and higher components and logistic costs. We increased our operating margin moving 210 basis points from above 8.5% two years ago to 10.6% for fiscal year 2022.

Overall, in fiscal 2022, our operational performance resulted in a record non-GAAP diluted net earnings per share of \$2.02, which came in above the midpoint of the guidance we gave at SAM 2022 in Houston last month, despite ongoing supply impacts, foreign exchange challenges and our exit from Russia and Belarus.

We generated the second highest free cash flow in the fiscal year, a total of \$1.8 billion, three times what it was in fiscal year 2020. We exited fiscal year 2022 with free cash flow at the midpoint of the target we guided at SAM 2022.

Our fourth quarter and yearend results position us for continued, durable, profitable growth in fiscal year 2023, and we are confident in the guidance targets we gave last month at SAM. Going into next quarter where optimistic demand will sustain globally. It is clear that customers view their data first digital transformation critical to their success, and are prioritizing hybrid cloud solutions to propel them forward, particularly in these dynamic times.

As we look ahead for the next fiscal year, after many quarters of supply constraint in our market, we are beginning to see some improvements. Demand from the consumer sector is slowing, allowing some substrate capacity to shift to enterprise IT technologies. As a result, we have been able to reduce anticipated lead times for some products. We are continuing to take proactive measures to mitigate supply chain challenges and we are working through our large order book, which has experienced no material cancellations. Over the course of 2023, we expect to see great and easy but not an end to supply shortages.

Despite supply constraints, the momentum we are generating with customers for our HPE GreenLake platform has been evident across our financial metrics. HPE GreenLake offers customers a unified and automated secure hybrid cloud experience, integrated across the edge data center colocations and public clouds. It is open, so customers can take advantage of the choice in architecture, but also benefit from the consistent cloud operating model HPE GreenLake provides for all workloads and applications across hybrid IT estates.

With a true cloud metering capability, HPE GreenLake enables customers to flex capacity up and down, based on their business needs while benefiting from a wide range of cloud services to protect and analyze their data. Our market-leading differentiators helped us attract more new customers to our platform during the fourth quarter than any other quarter before, leading to twice as many new HPE GreenLake logos to end fiscal year 2022 than we had a year prior.

Also, customers are consuming more HPE GreenLake services increasing usage above the original contract commitments. Our partners are also seeing the relevance of HPE GreenLake with our customers. Partners booked more HPE GreenLake orders during the fourth quarter than they ever did before, extending the strength of orders growth to 22 consecutive quarters. During the fourth quarter, we also saw a greater share of partners booking multiple HPE GreenLake deals.

Next week, we will meet face-to-face with several thousand customers and partners at HPE Discover Frankfurt, to discuss hybrid cloud transformation strategies, ways to drive value from the data across edge-to-cloud and how to bring the cloud experience to applications and data with HPE GreenLake. At the event, we will unveil important updates to our HPE GreenLake platform.

One European customer who has recently adopted the HPE GreenLake platform is SPAR. SPAR is the supermarket, you see everywhere in Europe from micro roadside convenience stores to massive one-stop hypermarkets. SPAR has decided to build its own hybrid cloud on HPE GreenLake to run the company's core business. Our platform is running all major applications of SPAR's innovation engine as the retailer pursues its ambition to create the future of grocery and retail shopping. The HPE GreenLake platform also helps SPAR use data to make strategic decisions on everything from warehousing and logistics to in-store experiences to advance its business. HPE GreenLake is playing an increasingly important role in customers' IT strategies and in addressing all their needs with one unified edge-to-cloud experience.

This fiscal year, we performed remarkably well for our customers, our shareholders and our HPE team members. We helped our customers use technology to accelerate the business outcomes while navigating in dynamic environment. Our expanding market leadership demonstrates the trust that customers place in us and the value defined in the differentiated edge-to-cloud portfolio that only we can deliver. Demand for our HPE solution has been enduring throughout 2022 and continue to be steady as we move into fiscal year 2023.

For our shareholders, by executing our strategy, we have pivoted HPE to a richer mix of software and services that is delivering recurring profitable growth. In fiscal year 2022, we posted strong revenue growth, record breaking non-GAAP earnings per share and outstanding free cash flow. I am so proud of our team members around the world who have made these results and our transformation possible through their ingenuity and engagement.

In fact, this year, HPE achieved one of the highest employee engagement scores in the history of our company, up 20 points over the last five years. Our culture has attracted some of the brightest, most innovative talent in tech. HPE's team members are bringing their energy and ideas to write HPE's next chapter and cement us as the edge-to-cloud market leader.

With our team engaged, our strategy taking flight and our market-leading solutions playing critical roles in customers' business, we entered fiscal year 2023 with incredible momentum on all fronts. And I look forward to advancing our strategy and leadership even further in the next year.

And with that, I would like now to pass it over to Tarek to make his comment and provide a little bit more details about our financial performance. So, Tarek, over to you.

Tarek Robbiati

Thank you very much, Antonio. Q4 was no question, an outstanding quarter for HPE. As usual, I will reference slides from our earnings presentation to guide you through our performance. Antonio discussed key highlights for Q4 '22 and fiscal year '22 on slide four and five. Let me discuss our Q4 performance details, starting with slide six.

Sustained demand continues to be a core attribute of our differentiated edge-to-cloud portfolio, which is translated to record or near-record results. As expected, year-over-year order growth continued to moderate in Q4 '22 to down 16% year-over-year as we lap challenging compares.

Having said that, our sequential order growth was flat relative to Q3 '22, which illustrates that demand for our products and services is steady.

The key takeaway here is that we are entering fiscal year '23 with an order book that is even higher than the order book we entered fiscal year '22 with, which attests to our momentum for fiscal year 2023. Now that we have closed fiscal year '22, we will again turn our attention to focus on revenues rather than orders as we have been flagging. This is because of timing differences, orders and backlog are not traditionally good indicators of quarterly revenue in normal times. We will continue to disclose orders for our as-a-service and HPE Pointnext OS business.

While the supply environment is improving, it is not quite back to pre-pandemic levels. Our large order book contributes to our confidence in our fiscal year '23 revenue outlook of 2% to 4% growth adjusted for currency, and the longer term 2% to 4% revenue CAGR outlook over the fiscal year '22 to '25 period we provided at our 2022 Securities Analyst Meeting in Houston last October.

We delivered Q4 revenue of \$7.9 billion, which is up 12% annually and 15% sequentially adjusted for currency. This is the second highest revenue figure since our separation transactions in 2017. It would easily have been the highest had revenue recognition from the Frontier deal not slipped into fiscal year '23. The Q4 sequential revenue growth is well above our prior outlook for at least 5% sequential growth.

We have had healthy demand throughout the past two years. We now also have improving supply as supply capacity in the consumer electronics markets is redirected towards enterprise markets where demand for digital transformation continues unabated.

We closed fiscal year '22 with full year revenue growth of 3% as reported. Currency and our exit from Russia and Belarus represented a 300 basis points headwind to revenue for the full year, which means we ended the year solidly above our initial guidance for 3% to 4% revenue growth adjusted for currency.

Our non-GAAP gross margins remain resilient, thanks to the pricing actions we have taken. Our 33.1% non-GAAP gross margin in Q4 is up 10 basis points year-over-year, reflecting a very strong Compute quarter and higher logistics costs in the Edge business. We retain our pricing discipline and continue to shift our mix of business towards higher-margin, software-intensive as-a-service offerings.

Non-GAAP operating margins reached a record 11.5%, which represented a 100 basis points increase sequentially and a 180 basis points increase year-over-year. This result would not have been possible without the strategic actions we have taken back in fiscal year '20 to reallocate resources and optimize our cost structure. These actions have put us in the position to benefit from an enhanced operating leverage for several quarters over the past three years, and this will continue in fiscal year '23 and beyond as Antonio and I remain determined to maintain our focus on productivity.

Our cost optimization and resource allocation program announced during the pandemic of 2020 and which is now substantially finished, has achieved annual savings of \$875 million, well above our initial target of \$800 million.

As a result, we are now right sized and we are entering a very different phase of the company, one where the combination of our enhanced cost structure and substantial order book is expected to deliver profitable growth that is increasingly recurring at higher margins as our as-a-Service transformation continues to unfold.

Thanks to revenue growth above our guidance, we delivered Q4 non-GAAP diluted net earnings per share of \$0.57, which exceeded the midpoint of our guidance range. This is the highest quarterly non-GAAP net diluted EPS figure since our 2017 separations. Our full year non-GAAP net diluted EPS of \$2.02 was at the upper end of our guidance range of \$1.96 to \$2.04 post-Russia and FX and near the midpoint of our SAM 2021 guidance. Again, we estimate FX impacts on our Russia exit combined for a \$0.17 EPS headwind in fiscal year '22.

Our GAAP P&L reflects a noncash write-down of goodwill in our HPC & AI and software businesses. Macro trends, including contracting market multiples and higher discount rates used in our impairment test for HPC & AI and software, respectively, significantly impacted this outcome. We continue, nonetheless, to be bullish on the HPC & AI segment given our clear number one position in the market and our outlook for this segment is consistent with what we said at SAM 2022 and software remains a critical component of our HPE GreenLake strategy.

I am particularly pleased with our free cash flow performance in Q4 '22, where we generated \$3 billion in cash flow from operations and free cash flow of \$2 billion as we work through our substantial orders and reduce our inventory. As Antonio mentioned, this brought our full year free cash flow to \$1.8 billion. This is triple our free cash flow in 2020. For the year, free cash flow met the midpoint of our guidance; in fact, our full year free cash flow met our initial pre-Russia and FX guidance from SAM 2021.

Finally, we are continuing to return substantial capital to our shareholders. We returned over \$1.1 billion in capital to shareholders this year, which represents over 60% of our free cash flow. We paid \$154 million in dividends this quarter and repurchased \$128 million in stock. That brought our buyback plan to \$512 million for the year, above our \$500 million target.

Our as-a-Service business momentum remains strong and this business is lifting our mix of higher margin recurring revenue. Total as-a-Service orders remain robust. Orders grew 33% in Q4 despite lapping 104% growth in Q4 '21.

On a constant currency basis, orders grew 43% in Q4 and our full year as-a-Service orders grew 68%. This indicates the long-term health of our as-a-Service portfolio and further strengthens our confidence in our three-year ARR target of a 35% to 45% CAGR from fiscal year '22 to fiscal year '25.

Our ARR of \$936 million represented 17% growth as reported and 25% growth in constant currency. For March of fiscal year '22, the industry supply constraints have limited shipments and weighed on our growth rate. We expect the improved supply environment to accelerate our ARR growth moving forward.

We also continue to expand our as-a-Services margin as our mix of software and services increased to 66% in Q4, up 4 points year-over-year, thanks to our cloud and SaaS offerings, particularly in Edge and Storage. As a result, the gross margins in our as-a-Service business remain meaningfully above our corporate gross margins.

Let's now turn to our segment highlights on the next slide. All revenue growth rates on this slide are in constant currency. In the Intelligent Edge, we delivered a record quarterly revenue number. We grew our revenues 23% year-over-year. We are outgrowing our main competitors and are taking share across wireless LAN, enterprise switching and SD-WAN including in some of the largest enterprise customers. Customers are increasingly adopting our Edge services platform and automation software suite. Our operating margin of 13.3% was up 2.4% annually, though down 3.2% sequentially with FX being the biggest contributor to the sequential decline. We continue to expect our Edge business to grow and perform like a Rule of 40 business moving forward.

In HPC & AI, revenue fell 11% year-over-year solely as a result of the Frontier deal slipping into fiscal year '23, which also impacted our operating margin in this segment. We are on track to close that deal in Q1 and have factored that into our guidance. We continue to have orders for HPC & AI solutions of about \$3 billion to be delivered in upcoming quarters.

Compute revenues grew 22% year-over-year to a near record of \$3.7 billion. The segment benefited from the multi-sourcing and demand steering initiatives we have discussed in prior calls, as well as steadily improving supply availability. We have clearly outperformed the competition in fiscal year '22 and our dynamic pricing strategy has helped us navigate a volatile supply climate while maintaining a healthy margin profile. Our Compute operating margin of 14.7% remains well above our long-term outlook for 11% to 13%, which attests of the best-in-class performance delivered by our Compute business.

In Storage, we are very pleased to report 6% revenue growth led by All-Flash Array and HCI. Electra is one of our fastest ramping new products ever and grew revenue 100% sequentially. In total, revenue from our own IP margin-rich products rose strong double-digits in Q4 and contributed to an annual operating margin of 15.9%, which represents a year-over-year gain of 210 basis points and a sequential gain of 120 basis points. Our storage transformation is now in full swing, as you can see, and we expect our storage business to deliver revenue growth in line with market with our own IP products growing above market. With respect to Pointnext Operational Services, combined with storage services, orders grew sequentially and for the year rose mid-single-digits in constant currency despite the exit of our Russia and Belarus business.

Finally, HPE Financial Services expanded its financial volume 3% year-over-year, and revenue rose 6%. Our operating margins fell 3 percentage points year-over-year as we adjust our prices for a higher interest rate climate. It is worth reiterating that our leasing profit dollars are well insulated from a higher rate environment over time as we price under spread and that our business is resilient in a downturn. Throughout the pandemic, our annual loss ratio never exceeded 1%. Our loss ratio is currently nearing pre-pandemic levels of approximately 0.5%. As a result, our fiscal year '22 HPE FS return on equity remained well above the 18% target we reiterated at SAM 2022.

Slide nine highlights our revenue and non-GAAP net diluted EPS performance. Antonio and I are very pleased that our strategic focus on both the top and bottom lines is evident in these results. Our revenue and EPS continue to grow despite the volatile supply environment, the exit from our Russia and Belarus businesses and increasing headwinds from currency. As mentioned earlier, during fiscal year '22, we experienced a headwind of \$0.12 from currency and \$0.05 from exiting Russia and Belarus. In spite of these headwinds, we met our SAM '21 non-GAAP guidance for fiscal year '22 and delivered a better mix of higher margin earnings across our portfolio as we continue to execute our edge-to-cloud strategy.

This improvement can be seen on slide 10, where we delivered non-GAAP gross margins in Q4 of 33.1%. This is a 10 basis point year-over-year improvement despite a significant revenue mix shift to Compute this quarter. Our growing gross profit and margin are a testament to the success of our strategic pricing actions through the supply challenges and the favorable mix shift we are driving towards higher margin products across our portfolio.

Moving to slide 11, you can observe that we have delivered an 11.5% non-GAAP operating margin for the company. This is not only up 180 basis points year-over-year and 100 basis points sequentially but it is the highest operating margin in the history of the company since our 2017 separations. Our very strong Q4 revenue performance and our resilient gross margins are certainly leading contributors to the operating margin expansion. And again, as I mentioned at SAM, this performance would not have been possible without the foundation provided by our resource allocation and cost optimization plan that we launched at the start of the 2020 pandemic.

On slide 12, let's discuss our setup in China through H3C. As disclosed at SAM, we have extended our existing put-option that is struck at 15 times trailing 12 month earnings through to December 31, 2022. We did this to allow our partners time to finalize their engagement with their stakeholders and make our final decision regarding our stake in H3C. Through our commercial contracts and equity interest, H3C has contributed a substantial amount to our EPS and free cash flow and our shareholder value in fiscal year '22. We will balance the strategic and financial benefits of a continuous involvement in China with rising risks, including geopolitical risk. We will keep you up to date as we arrive at a longer-term solution for this asset.

Our cash flow story on slide 13, attests of our outstanding execution. Our Q4 cash flow from operations and free cash flow were \$3 billion and \$2 billion, respectively. This is aligned to our normal pre-pandemic seasonality and our expectations of working capital tailwinds in the second half.

We have been strategically building inventory ahead of the competition throughout fiscal year '21 and fiscal year '22 to navigate the supply chain environment. Our inventory balances have now peaked and are beginning to decline as we enter fiscal year '23 and deliver on our substantial order book.

Our strong Q4 cash flow brought full year '22 cash flow from operations to \$4.6 billion and our free cash flow to \$1.8 billion. The \$1.8 billion is triple what we delivered in fiscal year '20. It is also at the midpoint of our guidance range of \$1.7 (billion) to \$1.9 billion despite the negative impact of Russia and FX that we estimate to be approximately \$250 million.

Now turning to our outlook on slide 14. As we discussed, demand for our products and services portfolio remained steady in Q4 relative to Q3. Our view remains one of enduring market demand given the megatrends of digital transformation and the explosion of data. We also believe our own portfolio differentiation will allow market share gains.

Let me reiterate that our guidance incorporates our current thinking on the macroeconomic picture, inflationary pressure and FX risk. I would like to remind all of you that approximately 55% of our revenue is generated in foreign currencies.

For Q1 '23, we expect revenue to be in the range of \$7.2 (billion) to \$7.6 billion, which at the midpoint, implies a mid-single-digit seasonal decline that we typically experience in Q1 relative

to Q4 of each year. We expect GAAP diluted net EPS of \$0.32 to \$0.40 and non-GAAP diluted EPS of \$0.50 to \$0.58.

While we are pleased with our Q1 outlook, we are cognizant given the macroeconomic environment and FX headwinds that it is too early at this stage to rethink our fiscal year '23 guidance. Given the points above, we consider it prudent to assume our year may be more weighted to the first half than is typical. We are, therefore, reiterating our full year '23 guidance. This includes revenue growth of 2% to 4% adjusted for currency, non-GAAP operating profit growth of 4% to 5%, GAAP diluted net EPS of \$1.38 to \$1.46, non-GAAP diluted net EPS of \$1.96 to \$2.04 and free cash flow of \$1.9 (billion) to \$2.1 billion. In terms of capital returns, we are maintaining our dividends and expect to buy back at least \$500 million worth of shares in fiscal year '23, just like we did in fiscal year '22.

So to conclude, our results speak for themselves in a test of our outstanding execution in a quarter that can be characterized by enduring demand for our differentiated portfolio of products and services. We look forward to continuing our execution momentum in fiscal year '23.

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

QUESTION AND ANSWER

Operator

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

And the first question will come from Wamsi Mohan with Bank of America. Please go ahead.

Wamsi Mohan

Yes, thank you and congrats on good results. I was wondering if you can comment a little bit about what the demand trends look like by region. It seems like a lot of companies are citing more of a slowdown like NetApp just now and Dell last week, I'm curious to get your thoughts on how IT budgets are shaping up for calendar '23. Most companies we are speaking with are more cautious about the near term, maybe the first half of '23 and optimistic more of a recovery in '23. And I think, Tarek, you just said that for you you're expecting, if I heard that right, like more confidence in the first half. So any color there would be helpful. Thank you so much.

Antonio Neri

Yes. Thanks Wamsi for the question. As we said in our commentary, we exited 2022 with a significant larger book than we entered 2022 and that demand was enduring. Honestly, was better than we anticipated and remains steady, because when you look at the quarter-over-quarter, Tarek mentioned was flat. But I think we have a point of differentiation compared to others, I think it's important to recognize. First, we have a diversity of portfolio from edge-to-cloud and you can see some of the results in the Edge, which obviously are outstanding. I think our HPE GreenLake is unique because it delivers a true hybrid experience that you can consume as-a-Service, and that's also dragging the entire portfolio.

And when I talk about customers, what we see customers continue to prioritize digital transformations. And a lot of that is driven by the need to automate, simplify, be more efficient in everything they do and also prioritize that data. The data insights to me are an important

aspect of what customers are looking for. And so, I think demand is there. I think in our case, probably it is better balanced. You asked a question about the Geos, I think the performance of the Geo has been even, I mean even across all the ten Geos that we have and across the segments. I got this question early on. Is...this is just an enterprise or a small business? No, it is the 10 Geos and all the segments from large to small, medium business.

In term of budget, just a month or so ago, we hosted what we call the Board of Advisory, and we have 25 customers that represent multiple industries. And the sentiment there is that they need to continue to digitize, and they need to continue to ensure technology plays a vital role. And again, these are technologies in the Edge, connectivity being one important aspect. The other one is obviously cloud, but cloud as an experience not just putting data in one place is a true hybrid approach and then this data, data-driven insights. And so, we are, I think, very uniquely positioned to capture that opportunity.

Jeff Kvaal

Thank you very much Wamsi. Chuck, next question, please.

Operator

The next question will come from Kyle McNealy with Jefferies. Please go ahead.

Kyle McNealy

Hi, thanks very much for the question. This one is for the Compute business. We assume a big part of it was driven by the supply improvement that you talked about, but units were only up 4% year-over-year. So there may not have been an incredible amount of backlog consumption. So can we talk a bit more about the AUPs? They're still growing at about teens year-over-year. It was high teens this quarter based on the pace of your price increases and the momentum of richer configs that you called out. How long do you think that this growth will continue and what is the durability of the AUP trajectory look like for you guys? Thanks.

Antonio Neri

Yes, Kyle, thanks. I think you understand the trends in our Compute business really well. So let me reiterate, we ended the year with record quarterly revenues of \$3.7 billion. This is a 22% year-over-year growth at constant currency. Unit growth was 4% and AUP was an increase in the high teens as you foreshadowed. And what's driving the demand for our Compute solutions is richer configs. Customers of all sizes are selecting our Compute solutions to run their private clouds and to power a multitude of workloads, data types and applications and Compute remains and will continue to remain a critical component of our customer transition towards modern edge-to-cloud architectures.

And you're right in saying that with these results and the unit increase, our order book in Compute remains strong as we enter fiscal year '23. So moving forward, trend-wise what you can expect is, obviously, this level of AUP growth to come down as we will have to pass on to our customers the benefit of commodity easing, but we feel very good about the prospects of Compute in fiscal year '23 given the order book, the fact that our products are more and more differentiated and the need for customers to continue to opt for greater configs.

Tarek Robbiati

And I will say, Kyle, we just introduced the Gen11 platform. And one of the key differentiation we have - actually, we have several - number one is our hybrid design. It was designed with hybrid in mind, meaning the solution gets deployed and managed from HPE GreenLake, whatever you deploy that. Number two is continued enhancement on the security side, which is

a point of differentiation. And one that is really coming up is sustainability. In our new offer, we actually provide customers with ability to optimize the Compute platform based on carbon footprint and consumption, and we give them also a carbon footprint report. So allows them to maximize the usage of the platform while they reduce that carbon footprint. So overall, we continue to see good momentum, and we are bringing new innovation in through the platform itself.

Jeff Kvaal

Thank you, Kyle. Chuck, next question please.

Operator

The next question will come from Shannon Cross with Credit Suisse. Please go ahead.

Shannon Cross

Sorry. Thank you very much for taking my question. I wanted to dig a little bit more into your as-a-Service business. Just looking at the absolute dollars, you had a stair step up to \$936 million annualized run rate during the quarter. And it looks like there was a significant uptick in the percent...well, at least 200 basis uptick in the percent of revenue coming from software services. So I am wondering what's behind that, and what trends you are seeing as you sign more and more of these contracts with your customers on a ratable basis? Thank you.

Antonio Neri

Yes. Thank you, Shannon. I think a couple of things. So first of all, we ended the year with a 68% year-over-year growth in our bookings. Today, we have now \$8.3 billion in total contract value. As you know, those contracts...can vary between three to five years. So, as you can imagine, that gives us a tremendous confidence that we will grow that ARR in the 35% to 45%.

We actually closed 2022 with twice as many new HPE logos that we enter now into the 2022 year. And then the important fact is why the mix is shifting is because the Aruba business is all a subscription business. And Tarek made a comment about the automation suite, obviously, Software-Defined Wide Area Network, and also the subscription to wireless or switching comes through the platform, but also the growth that we've seen in storage.

Storage had a great quarter, particularly on our own IP product. That's all software defined, and that's all subscription based. And what excites Tarek and me is the fact that in 2023, you're going to see an acceleration of that portfolio to HPE Alletra, which...HPE Alletra had 100% growth sequential. And obviously, that comes also with an incredible attach of Pointnext OS. And also, as we drive that data protection strategy, the incremental value comes from backup and recovery and disaster recovery and ransomware offers. We have now those offers integrated into HPE GreenLake. And so, that combination is what's driving the mix shift to more software and services rich offers.

Jeff Kvaal

Thanks Shannon. Chuck, next question, please.

Operator

The 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 we could dig into what you're seeing in terms of trends for the Compute business. In particular, what's catching my attention is after this very,

very strong result for the quarter, it sounds like you're confident in the outlook. And that stands in contrast to your biggest competitor in servers, which seems to be expecting a decline in calendar '23. So, if you could maybe do a little bit of compare and contrast as to why you might be seeing the world differently than they are if I'm interpreting your outlook correctly?

Tarek Robbiati

Okay. Sure, Simon. So I would say, if you refer to our prime competitor, I think some of their comments are referring to the consumer side of their operation, as much as, referred to their enterprise side.

Simon Leopold

Yes, I'm specifically looking at servers and Compute. So...

Tarek Robbiati

Yes. I think overall, so when you look at their results, they were, I would say, not too bad, we did much better than they did. And that is a function of many steps that we have taken in Compute. So there is Gen11 being one of our key solutions now are gaining traction in the market, as customers need bigger and richer configs moving forward. Our customers knew that Gen11 was coming, and they held their orders firm. So, we had no orders cancellations that are meaningful throughout fiscal year '22 and we finally got the supply that was there to be able to bring our customers to the Next Generation Compute environment. So, we feel very good about where we are. And to the extent that supply is there, we have a contrasting view relative to our...what our competitors are signalling with respect to their service business.

Antonio Neri

So I will add, Simon, that the demand has been enduring and steady throughout the years and throughout the four quarters in 2022. We exit the year with a significant larger order book. When I think about our differentiation, I think our Compute is differentiated because of HPE GreenLake. It's because of the experience we provide to our Compute platform.

And the fact also, if you recall, two years ago, we said we are diversifying our go-to-market as well, to attack profitable growth in segments where we did not participate as much, particularly more in the commercial to mid-market space. And one of the areas we saw great growth was through our channel ecosystem. And then, you couple all of that with our pricing discipline, and then you get the results of unit growth and revenue growth with amazing profitability. So, I think we have that tailwind. What Tarek covered is all about the revenue side. But on the demand side, it comes to those factors. And I think Gen11 is another step in that direction, which actually gives us tremendous differentiation.

Simon Leopold

Yes. Thanks.

Jeff Kvaal

Simon, thanks very much. Operator, can we have our next question, please?

Operator

The next question will come from Samik Chatterjee with JP Morgan. Please go ahead.

Samik Chatterjee

Yes, hi. Thanks for taking my question and congrats on the strong results here. I just wanted to see if you could talk about backlog or the order book in context of the segments of it, and how to

think about the supply improvement, particularly if you can shed some color on where backlog or order book remains most elevated related to normal exiting the year and as supply improves next year as you outlined, where can we see the most likelihood of digesting that backlog down to a bit more closer to normal levels? And it seems like you're expecting supply to remain sort of a constraint. So, backlog probably doesn't come back to normal by the end of next year, but any thoughts on that also would be appreciated. Thank you.

Antonio Neri

Well, as Tarek said in his comments, going forward, we're going to move away from all of these backlog orders and the like to focus on the revenue. That's why we gave the revenue guidance in Q1, because I think it's a better indicator of what we're going to see. I will say, in Q4 what we were able to incrementally convert from the backlog was mid-single-digits, and I can tell you the backlog, order book as we call it now, is very, very large. And in fact, in such segments, particularly in the Edge business, the order book is now bigger at the end of Q4 than it was at the end of Q3. So, the bottom line is that we see that enduring steady demand and we'll take up the entire 2023. And honestly, I'm not sure we will ever exit 2023 to back to historical level. I don't think that will be the case, because as good as we are trying to convert some incremental aspects of the order book as we go forward to some easing of the supply, the demand continue to be there.

So, I think it's going to take a little bit of time. And I think that the order book will return to normal, I would say, historical level, once the incremental capacity comes online, because we saw in this particular quarter some easing, it was because some reallocation of substrate came at the expense of the consumer business, which obviously is down, but the incremental capacity is not yet online, particularly in those older technology nodes, call it, 28, 40 and 65 nanometers, which is where the constraint is.

Jeff Kvaal

Thank you, Samik. Operator, can we have the next question?

Operator

The next question will come from Toni Sacconaghi with Bernstein. Please go ahead.

Toni Sacconaghi

Yes, thank you for taking the question. Your guidance for Q1 implies double-digit revenue growth on a year-over-year basis. For the full year, you're at 2% to 4%. So, is what you're seeing in Q1 really a reflection of confidence in backlog drawdown, or are you implicitly seeing demand slow over the course of the year? And then related to that, your free cash flow guidance is well below your net income for fiscal '23, despite the fact that you believe you can draw down the inventory further. Maybe you can help us with the bridge there. Thank you.

Antonio Neri

Yes. Thanks, Toni. Let me start then I will give it to Tarek. As we said, we gave the revenue guidance \$7.2 (billion) to \$7.6 billion. I'm not sure it's double-digit, but maybe high single-digit compared to Q1, 2022. But in any case, that guidance includes the recognition of the remaining part of Frontier, which obviously is an important aspect of the HPC. And then the ongoing ability to convert the order book as it comes in, plus the larger order book we already have. And then maintaining a certain level of margin, obviously, which we are confident based on our pricing and operating leverage actions we have taken. So, that's where we stand, and that's where we gave the guidance.

As we go through the year, we felt prudent at this point in time to maintain it because the FX uncertainty. Obviously, FX stabilizes or slightly improve, that full year guidance implies there is some potential upside. But also, it's going to come down to the supply availability, as I just made the comments early on.

In term of the free cash flow and the working capital, I will pass it to Tarek.

Tarek Robbiati

Yes. Well, thank you, Antonio, and thank you, Toni. So, our free cash flow for fiscal year '23 is going to be driven, obviously, by our earnings, but also reduction in restructuring expense and you will observe already between '21 and '22, when you have a chance to look at our 8-K filing that restructuring expense is dropping quite considerably and that trend will continue in FY '23 relative to FY '22. And the third variable to our free cash flow calculation is working capital.

So far, inventory levels have reduced between Q4 and Q3 in the amount of approximately \$400 million. We believe that inventory levels have peaked and we're going to work through our order book to continue to deliver on these orders and therefore, this will reduce our inventory levels. At the same time, if the demand remains as steady as we're seeing it, we'll probably need to continue purchases moving forward. So, I feel comfortable at this stage with the guidance we gave you on free cash flow of \$1.9 (billion) to \$2.1 billion, \$2 billion at the midpoint. Let's see how the year plays out, and we will think about giving you more color on how much free cash flow we can generate within that guidance or possibly more.

Jeff Kvaal

Thank you, Toni. Operator, could we have the next question, please?

Operator

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

Aaron Rakers

Yes, thanks for taking the question. Can you hear me?

Antonio Neri

Yes.

Aaron Rakers

Sorry, guys. I appreciate taking the question. Congratulations on the solid results. I want to go back to the Compute side of the business. As we look at the backlog dynamics and the commentary that you've already given, I'm curious of how you guys see component price deflation factoring into your expectations as we move forward. Put another way, how do you...how does the company operate, as far as, passing through, if its memory cost deflation and so on and so forth. How do we think about the progression of that as you think about the Compute business going through fiscal '23?

Tarek Robbiati

Yes. So, thanks for asking the question, Aaron, you know that we have posted in Q4 an operating profit margin in Compute at 14.7%, which is the highest it's ever been, and it's higher than the outlook we guided you all at SAM, long term OP margin in Compute of 11% to 13%. And the reason why we have that difference is that we believe as supply continues to ease there will be the need for us to adjust our pricing down to continue to grow the business moving

forward. So, the level at which the AUPs are at today, will come down as we pass on the reduction in costs from commodities, DRAMs in particular.

We're starting to see some of this, but its early days and what's very, very important in Compute on the way up, just like on the way down is to be extremely reactive and dynamic with our pricing. And we have now the ability to do so globally to push changes in our list prices through our ERP system over a weekend it needs to be to react to changes in commodity prices and what we're seeing in the competitive environment. So, we remain with our business unit of Compute and the management team, they are extremely focused on competitive pricing dynamics because for us, it's really critical as we foreshadowed to you that we maintain scale in Compute and continue to capture the lion's share of the value in the industry, which we are doing today.

Antonio Neri

And in 2022, we have shown that we are the best are executing that strategy. No questions.

Jeff Kvaal

Thanks, Aaron. And Chuck, why don't we make this the last question?

Operator

Yes, sir. Our final question will come from Amit Daryanani with Evercore. Please go ahead.

Amit Daryanani

Thanks. Yes, I guess my question is really around the Intelligent Edge business and maybe two parts. One, if you could just talk about the 23% growth here is fairly impressive. Any details you can give on what is driving that from a product basis or even backlog versus end demand would be really helpful to understand. And then Tarek, if I remember, at SAM, you talked about mid 20% operating margins in Intelligent Edge over time. As you look over the path from 13.3% to mid 20%, what do you need to get there? Is there a revenue number or something else just helpful to understand the margin expansion bridge from here? Thank you.

Antonio Neri

Yes. Let me start, and then Tarek can talk about the margins. I want to be clear. The Edge, 100% demand driven has nothing to do with backlog or any of that. The order book continued to grow in this business. And we are winning. We are taking share. And the reason why we are taking share is because we have a true differentiated value proposition that's built on three particular layers of the architecture. One is the unification of the connectivity layer with wireless LAN switching and SD-WAN capabilities. These are both organic and inorganic investments we make over time, remember, we did the Silver Peak acquisition. We have unique differentiation through our security layer with SASE through both organic and partnerships. And then we have a best-in-class AIOps that's delivering tremendous value for customers to drive new experiences, to automate everything they do across the enterprise and is 100% driven by the demand at this point in time.

Tarek Robbiati

Yes. So, let me elaborate on what Antonio said with regard to your portion of the question that pertain to operating margins. Our operating margin for the Edge was 13.3% in the quarter. It was up annually by 2.4%. It was down sequentially 3.2%, but it was up annually 2.4%. I think here you have a mix effect that is at play between as-a-service offerings and NaaS offerings that play a role in the way the margin fares in the short-term. It obviously if we're entering the NaaS market, that is because we expect to see the margins, the gross margins of NaaS to

improve over time. So that is one factor. The other factor that has affected the margins very short term, very tactically in Q4 is logistics costs, and I flagged that in my script. Logistics cost in Aruba were higher than we would have liked. But that again is changing.

And so, we expect Aruba to perform as a Rule of 40 company moving forward. And that's the ambition that we have in the medium to long-term, which is to maintain high double-digit growth in Aruba and operating profit margins in the mid-20s range. We're comfortable with that outlook that we announced at SAM.

Antonio Neri

Well, thank you for all the questions and thank for making the time today. I want to close with a couple of more additional thoughts. Obviously, we had an outstanding quarter, an exceptionally well-executed quarter for us with record-breaking results across key performance metrics. But when you reflect back, and this is my 20th quarter as the CEO reporting earnings, this is a combination of many things we have done over the last few years. And it's not just a onetime thing.

When I think about that, first and foremost, we have a clear strategy we have been executing and accelerating and is winning in the market and is winning with customers. When you have twice as much logos that we had at the beginning of the year, that tells you customers are entrusting their transformation to HPE.

Second is, we are executing better. No question about it, and Q4 was a great example of that.

Third is that the demand for our solutions remained steady. And I understand the question about, well, your competitors may have, or other vendors have different views. I cannot comment on their views. I'm just telling you, after twenty quarters what I see and what we say we do. So, in the end, you probably have to take at the face value what we tell you, and we deliver against that.

And then, last but not least in 2020, Tarek and I on Q2 2020, when the pandemic started, we came here if you recall, and we told you we're going to enact a program to reallocate resources to high-growth, high-margin areas and right-size the company. We believe we are right-sized going forward. And those actions are paying off, not only because we delivered \$175 million net savings to shareholders, but because we have now different talent in different locations that give us the confidence that we can execute the strategy.

So, it's a combination of four different things we have done over and over and over. In Q4, obviously, with a little bit of easing on supply, we're able to translate all the hard work into record-breaking results. And most importantly, gives us the confidence that we entered 2023 with an amazing momentum, and that's why we give the guidance that we give you. And we can all see every quarter where we stand, but we feel pretty good about our ability to deliver and potentially even exceed those numbers we gave for the full year.

So, with that, thank you very much. If I don't speak to you before the end of the year, I wish you a happy holidays to you and your families. So, thank you for your time today.

CONCLUSION

Operator

Ladies and gentlemen, this concludes our call for today. Thank you and have a great night.