Hewlett Packard Enterprise

Fourth Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Meg Whitman - *Chief Executive Officer*

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

Andrew Simanek – *Head of Investor Relations*

PRESENTATION

Operator
Good afternoon and welcome to the Fourth Quarter 2017 Hewlett Packard Enterprise Earnings Conference Call. My name is Austin and I'll be your conference moderator for today's call. At this time, all participants will be in listen-only mode. We will be facilitating a question and answer session towards the end of the conference. Should you need assistance during the call, please signal a conference specialist by pressing the star key followed by zero. As a reminder, this conference is being recorded for replay purposes.

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

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

Before handing the call over to Meg, let me remind you that this call is being webcast. A replay of the webcast will be made available shortly after the call for approximately one year. We posted the press release and the slide presentation accompanying today's earnings release on our HPE Investor Relations webpage at investors.hpe.com.

As always, elements of this presentation are forward-looking and are based on our best view of the world and our businesses as we see them today. For more detailed information, please see the disclaimers on the earnings materials relating to forward-looking statements that involve risks, uncertainties and assumptions. For a discussion of some of these of risks, uncertainties and assumptions please refer to HPE's filings with the SEC, including its most recent Form 10K.

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 on HPE's annual report on Form 10-K for the fiscal year ended October 31st, 2017.

Finally, for financial information that has been expressed on a non-GAAP basis, we have provided reconciliations to the comparable GAAP information on our website. Throughout this conference call all revenue growth rates unless noted otherwise are presented on a year-over-year basis and beginning with fiscal year 2016 are adjusted to exclude the impact of divestitures and currency.

We believe this approach helps provide a better representation of HPE's operational performance. Please refer to the tables and slide presentation accompanying today's earnings release on our website for details.

With that, let me turn it over to Meg.

Meg Whitman
Thanks Andy, and thanks to everyone for joining us on the call.

As you've all seen, we just announced that I will be stepping down as CEO of HPE at the end of Q1. Antonio Neri, HPE's President, will become President and CEO, and join the HPE board, on February 1, 2018. I will remain a director on HPE's board.

I've said for many years that the next leader of HPE should come from within the company, and Antonio is exactly the type of leader I had in mind.

Antonio is a 22-year veteran of our company who began his HP career as a customer service engineer in the EMEA call center. He is a computer engineer by training, has a deep technology background and is passionate about our customers, partners, employees and culture. The board unanimously agreed that Antonio should be my successor.

This transition is possible because of all the work we've done during the past 6 years to transform HP. Many of you will recall the challenges the company faced when I became CEO, and will recognize how far we've come…

During the first couple of years, we focused on strengthening the company across a number of metrics. We stabilized and strengthened the leadership team, improved productivity and reinvigorated the culture. We significantly improved customer satisfaction, driving NPS scores from negative in some cases to an industry-leading 80 for our services today. And, we pivoted hard back towards partners, rebuilding our entire partner ecosystem and shifting resources to this critical go-to-market channel. We also rebuilt our balance sheet, paying off the nearly $12 billion of operating company net debt that existed when I joined the company. I'm proud that today, HPE is exiting the year with nearly $6 billion in net cash.

Most importantly, we reignited innovation and delivered groundbreaking new technology solutions. For example, we invested in the Machine Research project, which is focused on creating an entirely new computing architecture for the big data era, putting memory at the core. We introduced the first prototype earlier this year and have also begun incorporating certain technologies from the project into solutions available today.

From a much stronger position, we then looked at our portfolio and made a number of strategic decisions to further sharpen our focus and accelerate performance.

The first critical step was the separation into two independent, Fortune 100 companies – HPE and HP Inc. This was exactly the right decision because it allowed both companies to optimize for strengths and invest in core strategies.

From there, we further separated the company by spinning off and merging our Enterprise Services business with CSC, creating the world's largest pure play IT services company.

Next, we spun off and merged our application Software business with Micro Focus, creating the seventh largest pure-play software company in the world. The ES and Software transactions delivered more than $20 billion in value for HPE and our shareholders.

We also made a number of smaller divestitures, including Tipping Point and Mphasis. And, we divested 51% of our China business to Tsinghua Holdings, creating New H3C Group, the leading Chinese provider of technology infrastructure. This unique approach has put us in a strong position to capitalize on the second largest IT market in the world.

We also made a number of strategic additions to strengthen our portfolio in key growth areas…

For example, in Hybrid IT we acquired SGI, to strengthen our high-performance compute business…Simplivity, to bolster our hyperconverged offering…and Nimble Storage, to complete our storage offering from entry level to the high end and accelerate our transition to all-flash.

We acquired Aruba, the leader in wireless networking, which has become the heart of our Intelligent Edge strategy. Since then, we've strengthened Aruba with Niara, bringing machine learning and big data analytics to network security…and Rasa Networks for network performance management and analytics.

And, we've also enhanced our services capabilities. We acquired Cloud Technology Partners to extend our cloud consulting expertise…and Cloud Cruiser to enhance our IT consumption models, like our Flexible Capacity offering.

All of these acquisitions are highly complementary to our core business. These companies are all in growth markets and we are accelerating their performance by leveraging our go-to-market channels.

We also continued to invest organically and introduce exciting new products and services. For example, we launched the industry's first composable offering, called Synergy, and we now have more than 1100 customers on the platform. In high performance compute, we launched Apollo, which is helping to bring supercomputing capabilities to the enterprise. To address the explosion in Industrial IoT, we launched our highly differentiated Edgeline converged systems. With security becoming a board-level issue, we launched the industry's most secure standard server. And, beyond product innovation, we continue to introduce new services offerings, like our Flexible Capacity, which provides flexible, pay-per-use IT for customers.

The industry recognizes the progress we have made. For the first time, HPE is a Gartner Magic Quadrant leader in all of its core business categories.

As a whole, these moves have paid off and I'm very proud of the shareholder value we've created along the way.

HP and then HPE have returned nearly $18 billion to shareholders through share repurchases and dividends since 2012. And, since the birth of HPE on November 2, 2015, we've delivered a total shareholder return of 89% – which is more than 3 times that of the S&P 500. I know Antonio will have the same focus on delivering value for our shareholders going forward.

By fixing, improving and repositioning the company I joined, HPE has worked its way into a strong competitive position, ready to drive the next phase of shareholder value. And you're starting to see the payoff in our results.

In Q4 FY17, we grew revenue 5% year over year, capping a full year FY17 where we grew the top line 1% when adjusted for currency and divestitures. We have stabilized our core rack and tower server business, which grew 6% and 7% year over year in Q3 and Q4, respectively. Services grew 3% in Q4. And, our investments in key growth areas like the intelligent edge, high performance compute and all-flash storage are clearly paying off. Aruba performance continues to accelerate and outpace the market, growing 19% in Q4 and 22% for the year. Our High Performance Compute portfolio is the best in the industry, and we continue to win deals and extend our market leadership position. HPC was up 28% in Q4 and 37% for the year.

From a profitability perspective, we are on the right track towards getting margins back to historic levels despite continued challenges in commodity pricing. In Q4, EG margins improved sequentially for the second quarter in a row to 10.6% as we executed our cost take out plans and shifted resources to align with our market segmentation. We are confident in our ability to achieve our full year target of 11-12% in FY18.

At every turn, HPE is preparing itself for the future…

In Q4, we moved into the execution phase of HPE Next, our program to redesign the company to be purpose-built for todays and tomorrows competitive environment. HPE Next is all about simplifying the way we work, driving execution and investing in innovation that will differentiate our solutions in the years ahead.

While executing HPE Next, we've made sure to minimize disruption to the business, and particularly our sales force. I'm very pleased that we saw no disruption in Q4. In fact, HPE Next has galvanized the entire company around our vision to drive tremendous value for customers, partners and ultimately shareholders.

And all of this is being driven by the strong leadership team we have in place…

In addition to Antonio, I hope it was clear at our Analyst Day last month what a deep leadership bench we have, with Alain Andreoli running Hybrid IT, Ana Pinczuk running Pointnext services, and Keerti Melkote running Aruba. Phil Davis, our new Chief Sales officer has already brought tremendous energy to the new role. And Irv Rothman continues to do an excellent job running Financial Services.

Together, this team has honed and refined our go forward strategy, which is crystal clear and laser focused…

First, the world is becoming Hybrid and we make Hybrid IT simple. We do that through offerings that help customers optimize their core IT environments with secure, software-defined technologies that seamlessly integrate across traditional IT and multiple public and private clouds. Hybrid IT will give customers a new level of transparency and manageability for all of their applications and data from the core, to the cloud, to the intelligent edge. But our vision doesn't end there. Simplicity ultimately means IT that is invisible and autonomous. And that is exactly what we plan to deliver.

To that end, just this morning we announced that we have rolled out HPE Infosight, our highly differentiated predictive AI technology, across our entire 3PAR portfolio. This is going to be a game changer for our storage business. HPE Infosight, which came with the Nimble acquisition, is the industry's leading predictive analytics platform that brings software-defined intelligence to the data center with the ability to predict and prevent infrastructure problems before they happen. Leveraging advanced machine learning, HPE InfoSight is the next step in our vision for an autonomous data center.

And, next week at Discover Madrid, we will officially introduce Project New Stack. New Stack is all about what our customers want most – simplicity and control. It's a Hybrid IT management platform that lets you deploy, operate, and optimize public cloud and on-prem private cloud environments through a simple and unified experience. And, it will accelerate app development and deployment with integrated dev ops capabilities. This is what our customers have been asking for and no one else in the market can match the platform we've created.

Second, we power the Intelligent Edge. We have highly differentiated offerings in this area that are helping customers drive a revolution across their business – from the factory floor to the retail store. Whether it is with our wired and wireless connectivity offerings from Aruba that allow customers to securely connect edge environments and drive new experiences for their customers and employees and new revenue streams for their bottom line…our Edgeline converged systems that bring storage and compute directly to the source of the data that needs to be analyzed…or, our Universal IoT software platform that seamlessly integrates data from disparate IoT systems at massive scale. These are all areas where we are well ahead of the market.

And the industry is taking notice. Earlier this fall, Aruba was named a leader in Gartner's magic-quadrant for wired and wireless networking, and placed first for vision. This is the first time that Cisco has ever been displaced from this position.

Third, Services are more critical than ever. More and more, everything we do is driven by our services expertise across Advisory, Professional and Operational Services. We are also seeing growing interest in consumption services as our customers look to us for financial flexibility through pay per use models.

Our offering in this area, flexible capacity, is different than anything else on the market. Through our services-led solutions, combining hardware, software and financing, we make operating IT simple and elastic, and because we offer a "pay-per-use" model, based on metered usage, customers never overpay on technology they don't use. Look out for more news in this area at Discover next week.

Let me say in closing that it has been the privilege of a lifetime to lead the company founded by Bill Hewlett and Dave Packard. I'm proud of what we've accomplished during the past 6 years. We've laid out a strong foundation for a prosperous future, and now is the right time for Antonio and a new generation of leaders to take the reins. I look forward to experiencing HPE's progress as a board member and am very confident that Antonio will enjoy tremendous success.

And now, I will hand the call over to Tim, who will provide details on the financial results.

Tim Stonesifer
Thanks Meg.

Before I jump into the results, I just want to thank you for your tireless leadership of HP and personal mentorship to me over the past two years.

I'll miss our day-to-day interaction but look forward to working with you as a board member and partnering closely with Antonio going forward. In fact, I joined HP as the CFO of Antonio's business, so we have a long-standing relationship that will make this transition seamless.

So, turning to our performance, in Q4 we saw solid revenue growth, sequential operating margin improvement, and better than expected earnings. Our results in the quarter gives me confidence that we are making the right moves to deliver on our FY18 commitments and drive long term shareholder value.

Total revenue for the quarter was $7.8B. This includes $174m, or one month, of Software, which is accounted for in discontinued operations. Revenue from continuing operations was $7.7B, up 5%, and when excluding Tier-1 server sales was up over 11%. I'll dive into the business segment performance in a minute.

From a macro perspective, we continue to see a broadly improving IT spend environment but competitive pricing and commodities remain headwinds. The exchange rate improved in the quarter, leading to a neutral impact year over year in Q4.

By region, HPE's performance in the Americas remained steady, as core compute stabilized and networking growth accelerated, offset somewhat by softer organic storage results. Revenue in Europe was also driven by networking and continued to grow, with mid-single digit growth in Germany, France, and Iberia. Asia Pacific delivered strong core server sales with growth in Japan, Australia, India, and China.

Turning to margins, the gross margin of 29.7% was down 210 bps year over year but up 40 bps sequentially. Non-GAAP operating profit of 8.2% was down 100 bps year over year but up 130 bps sequentially. In addition to normal seasonality, we saw continued benefit from our cost take out actions and from a better mix as we continue to shift our focus towards the value and growth segments of the market and away from custom commoditized servers. These benefits helped offset the continued challenging pricing environment, and elevated commodities costs with DRAM increasing another 5% to 10% over the prior quarter.

Non-GAAP diluted net earnings per share of $0.31, is above our previous outlook of $0.26-0.30, primarily due to more cost savings, a lower tax rate, and favorable other income & expense. Non-GAAP diluted net earnings per share primarily excludes pre-tax amounts for transformation and restructuring charges of $439M, separation costs of $272M, amortization of intangible assets of $96M, and hurricane Harvey related charges of $93M offset by separation related income tax adjustments of ($785M).

GAAP diluted net earnings per share was $0.32, above our previously provided outlook range of $0.00 to $0.04, due primarily to a non-cash income tax benefit as a result of transactions we undertook in connection with the Software spin-merge and in anticipation of potential tax reform.

Now turning to the results by business**…**

In the Enterprise Group**,** revenue was up 1% year over year and up 7% excluding Tier 1 Server sales, as we stabilized the core rack and tower servers business and saw strong momentum in key growth areas like Aruba wireless, campus switching, all-Flash Storage, and PointNext.

Operating margins were down 270 bps year over year, however they improved 130 bps sequentially to 10.6%. The sequential margin improvement is primarily the result of the cost savings plans we are executing and mix benefits from lower Tier 1 server sales and higher PointNext revenue.

Server revenue was down 5% year over year, but grew 6% excluding Tier 1 as we executed our plans to exit the custom commoditized server market. We executed well in our core rack and tower server business, driving 7% growth as richer attach configurations drove higher AUPs. Looking forward, as discussed at our Analyst Meeting, we are changing our approach to the volume server segment by exiting custom commoditized servers and moving to a low or no-touch model for core rack and tower. This will make us easier to work with and will help us further expand our profitability. In our value and growth portfolio, which carries higher margins and better services attach, High Performance Compute grew almost 30% with SGI, and 2% organically. And, Synergy also continues to ramp growing over 60% sequentially and now has over 1,100 customers.

Storage revenue was up 5% driven by the Nimble acquisition. All-flash arrays grew 16% year-over-year with Nimble up over 80%, which continues to outpace expectations. 3Par performance was soft due to a tough competitive environment in the midrange and some go-to-market challenges in America. We are addressing these challenges head on by bringing together the Nimble and 3PAR sales team under a new leader, Keegan Riley, who led sales at Nimble, and are aggressively hiring more storage specialists for the field. As Meg mentioned, we are also rolling out Infosight, Nimble's predictive AI technology across our entire 3PAR portfolio. We are confident that these actions will quickly turn things around.

Networking continues to perform very well, with revenue up 21% driven by campus switching, which was up 28%, and Aruba wireless solutions, which grew over 19%. We continue to be encouraged by the very strong Aruba lead pull-through of campus switching, reinforcing both the Aruba investment thesis, and the strength of the new Aruba branded switching portfolio. We are also getting excellent feedback from our new Aruba core aggregation switch. In total, networking grew across all product groups and geographies.

Technology Services, including PointNext, grew revenue for the sixth consecutive quarter, up 3% year over year. Orders returned to growth, up 3% year over year, led by better than 4% growth in support. Within support, both attach and non-attach orders grew, with double-digit growth in flex capacity and data center care. We also continued to increase our services intensity, which offset lower hardware unit sales.

HPE Financial Services revenue grew 22%, driven by a large one-time lease buyout and continued lease conversions. Excluding these items, revenue increased 1%, the sixth consecutive quarter of year over year growth. Financing volume was down 2% as solid growth in our direct business was offset by declines in our indirect business. Operating profit declined 250bps year over year to 7.7% reflecting one-time items and the increased operating lease mix. The return on equity for Q4 was 13.2%, up 210 bps sequentially.

So, looking back at the quarter, I am pleased with the progress we have made, and encouraged by not only our improving financial performance, but also many customer wins. For instance…

The NASA Langley Research Center is now using our HPC clusters to test and help solve problems involving the physics of advanced propulsion. We expect our relationship with NASA to grow as we add capability to their new HPC datacenter going forward.

CenturyLink, the second largest U.S. communications provider chose 3PAR with Data Center Care support for a recent IT refresh.

Aruba announced a partnership with Purdue University's College of Agriculture to help develop and deliver a digital agriculture program that will revolutionize farming and food production for a growing, global population.

PointNext won a significant deal with the Walt Disney Company.

And, we are helping the biggest and oldest bank in India, the State Bank of India, with its digital transformation.

These are just a few of the many wins we had in the quarter, but I think they demonstrate the solid momentum we are seeing and some of the opportunity ahead.

Now, turning to cash flow…Free cash flow was better than expected at $370M, benefitting from continued improvement in working capital. The cash conversion cycle improved 6 days sequentially to negative 27 days driven primarily by increased payment terms.

We returned $725M to shareholders during the quarter, including $105M in dividend payments and $620M of share repurchases. For the full year, we returned $3.0B to shareholders, in-line with the commitment we laid out at the beginning of the year. We ended the year with an operating company net cash balance of $5.8B, slightly below our guided range of $6.0 to 6.5B, due to the timing of a payment associated with the spin-merge balance sheet true-ups. We anticipate receiving this payment of approximately $200M in Q118.

Turning to our outlook…We recently gave detailed FY18 guidance at our Securities Analyst Day, and I encourage you to review my presentation for a more detailed discussion of that outlook. However, I think it's worth reiterating a few points. We continue to expect FY18 non-GAAP diluted net earnings per share of $1.15 to $1.25. We expect normalized free cash flow of $2.0B and as reported free cash flow of $1.0B. And we remain committed to returning $2.5B of capital to shareholders in the form of $2B of share buybacks and $500M of dividends, which we just increased by 15% from $0.065 to $0.075 per share each quarter. Our board also recently increased our share repurchase authorization by $5.0B.

As we discussed at our analyst day, FY18 EPS will be back-end loaded towards the second half. There are a few reasons for this. First, the cost savings and business simplification benefits from HPE Next will ramp throughout the year. Also, the earnings contributions from our recent acquisitions will become more accretive as the year progresses. We'll also see the benefits from share buybacks compound throughout the year. And, we should get a natural mix benefit as our higher-margin value products and services become a greater percentage of our business. As a result, we expect Q1'18 non-GAAP diluted net earnings per share of $0.20 to $0.24, and we expect GAAP diluted net earnings per share to be $0.01 to $0.05.

Before I turn it over to Q&A, I want to briefly touch on our reporting structure for next year. Beginning in FY18, we will report three segments: Hybrid IT, which includes: Servers, Storage, Datacenter Networking, and Point Next; Intelligent Edge, which includes: Wireless LAN, campus and branch switching, edge compute, and Aruba services; and lastly Financial Services. This new cut of our business more accurately reflects how we go to market and how we have begun to manage the business internally in FY18. We will provide restatement tables towards the end of our first quarter.

Overall, like Meg, I am very pleased with the performance this year. The work we've been doing over the past couple of years is paying off and we are well positioned for the FY18.

Now 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 star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys, to withdraw your question, please press star then two. We also request that you only ask one question and one follow-up question.

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

Sherri Scribner
Hi, thank you. I just wanted to dig a little bit into the different segments, if you look at the storage business it decelerated a little bit, and I guess I would've thought that storage might have grown a little bit more sequentially, was that primarily related to some of the issues at 3PAR because it sounds like the all-flash array and the Nimble business are doing well?

Meg Whitman
Yes, it's Meg, the storage revenue was up 5% driven by the Nimble acquisition, and as you said the all-flash arrays grew 16% with Nimble was up over 80%, so a good performance overall. But as Tim mentioned, 3PAR performance was soft due to I think a very tough competitive environment in mid range and then some sales challenges in the United States. We are taking action, we are combining the Nimble and 3PAR storage sales teams which is going to give us more critical mass there and that's going to be led by Keegan Riley who led sales at Nimble. We are also going to aggressively add some more specialists to the field. I think you hit it right on the head a little weakness in the US and we are fixing it.

Tim Stonesifer
I think also InfoSight will help as we roll that across the 3PAR portfolio.

Sherri Scribner
Okay, great. Just on the server business that also decelerated, but I know you have a strategy shift in that business, was part of the decline in service related to that strategy shift and as we move into '18, should we expect the server business to decline because of the less focus on the lower margin business? Thanks.

Meg Whitman
No, I think you have got this exactly right. Servers had another strong quarter outside of Tier 1. Remember, we had quite a large Tier 1 service provider business that had a fair amount of revenue, but not much profit associated with it, but outside that it grew 6%. That was execution, market improvement and some good traction in our higher value offerings. In addition to stabilizing core RAC and tower we are pivoting hard to our value and growth offerings like HPC, Synergy, SimpliVity, et cetera, but you will see some declines in the server business next year as that Tier 1 business continues to bleed off.

Sherri Scribner
Thank you.

Andrew Simanek
Great, thank you, Sherri. Can we have the next question, please?

Operator
Our next question comes from Katy Huberty with Morgan Stanley. Please go ahead.

Katy Huberty
Yes, thank you. I just wanted to follow-up on the server comments. Curious whether Intel Purley product cycle is impacting the business yet or is that a catalyst that you think hits in calendar 2018. And then when you think about annualizing the Tier 1 base of business when do you think the server category on a reported basis can get back to growth?

Meg Whitman
Why don't you take the ex-Tier 1 server growth and I will take the other question.

Tim Stonesifer
Sorry about that. Yes, as far as the Tier 1 component, I would say that probably runs off to an immaterial amount probably in the late 2019-2020 timeframe.

Meg Whitman
Great, and then listen, our Gen10 server which is on the new Intel chip called Skylake, is off to a good start. There is some concern in the industry that because there is not quite the features and functionality advancement that there normally is in their tick tock that, that might be a slower ramp, but thus far we are not seeing that. We are cautiously optimistic about Gen10. What I will say based on Skylake, what I will say about Gen10 is we have a real point of difference in Gen10 which is we have produced the most secure server in the world. Security is built in as a route of trust into the silicon. No one else has anything like this and this is making a real difference because security continues to be an enormous issue for everyone. Let's stay tuned on Skylake. We are not seeing any diminution of that tick tock, but we will have to see how it plays out.

Katy Huberty
Thank you.

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

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

Tony Sacconaghi
Yes, thank you. One for Meg and then maybe one for Tim or Meg. Meg, just in terms of the timing of your announcement to hand over the reins to Antonio, I got to say, I am a little surprised, I think in the last three months you have said things like, I am not going anywhere and there is still more work to do and I have no plans to leave. This in light of those comments feels a little abrupt. I am wondering, if maybe you can add some color in terms of was there a change of heart? I would certainly say that there is still a long ways to go in terms of improvement in the server business and margins were down almost 300 basis points year-over-year. There still is a lot of work. It's not entirely obvious to an outsider that HP is at some ready point for a change. Maybe you could add some color?

Meg Whitman
Yes. Tony, I would say there hasn't been a change in sentiment. What I think is absolutely true is Antonio is ready to take the reins and go the distance. If you think about it, we have a much smaller, much nimbler, much more focused company. I think it is absolutely the right time for Antonio and a new generation of leaders to take the reins. We have got a very good leadership bench; we have got a strategy that is crystal clear and focused. Antonio is a deep technologist.

I have added a lot of value here in terms of shareholder value creation, financial restructuring, ignition of the innovation engine, but the next CEO of this company needs to be a deeper technologist and that's exactly what Antonio is. He has been with the company 22 years; he is a trained computer engineer and has worked in almost every business of this company. I just think it's the right thing.

I also think Antonio is going to lead the next phase of value creation. We have created a lot of shareholder value here. over 220% shareholder value from right before the announcement of the turnaround in the fall of 2012, just HPE alone 89% increase since the separation which is three times the S&P 500, and HPE Next and the simplification of our business and the execution of the strategy that Antonio and I put together between the two of us, he is going to lead that next generation of shareholder value creation.

Tony Sacconaghi
Just secondly and separately, you had commented on DRAM prices being up another 5% or 10% this quarter. I am wondering; A) if you can comment on why that doesn't make you less confident about your ability to hit margin targets. And B) whether you can comment on whether the competitive pricing environment has improved at all. Quite frankly, I was looking for more in terms of sequential margin improvement in the enterprise group, especially giving all the cost-cutting you were doing. I am wondering, if you gave some of that back, because of DRAM in competition?

Tim Stonesifer
The margin expansion if you look at Q4 the 10.6 was up 130 basis points. We were to continue to improve margins primarily driven by the $200 million to $300 million cost actions that we talked about in Q2 of '17. What gives us confidence despite DRAM is up another 5% to 10% in Q4. As we look forward into 2018, we still have a lot of tailwinds, right. We talked about it at SAM. If you look at HPE Next that $250 million of net savings we are on track to do that now. I will say that is roughly two thirds of that is in the back half of the year. As you think about quarterly splits and margins I would take that into account, but we feel very good about what's going on there, we continue to right size the cost envelopes of the recent acquisitions that we've done those will become more and more accretive as we go through 2018. We have a lot of things that we think will continue to improve margins and we still feel based off of what everything you see today, we feel good about 11% or 12%.

Meg Whitman
The other thing I would add to that Tony is, this strategy to pivot to the value in the growth segments of our portfolio is absolutely critical because, just a mix shift of a couple percent actually increases the operating margin. We anticipate that that will happen as we realign the sales force, as we focus marketing on the value and growth segment and we realize the potential of the portfolio. I would say the competitive pricing environment is maybe slightly mitigated, but it would be hard for me to gauge that because it varies by country, it varies by product line and it shifts from month-to-month and quarter-to-quarter. While I would say overall,

there's been some mitigation in that pricing environment, I would not say it is universal and we are not counting on that for the delivery of our operating margin in 2018.

DRAM pricing appears to now be leveling out, and you talk to people in the industry, it appears that supply is now beginning to match demand there is going to be more supply I think from the key vendors of memory. We will see what happens. We are not counting by the way on to deliver our results on a drop in DRAM pricing, we are also not counting on another 15%-20% increase in DRAM pricing, but we feel pretty good about where we are, and I got a lot of confidence that we are going to hit our $1.15 to $1.20 and the 11% to 12% operating margin.

Tony Sacconaghi
Thank you, Meg.

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

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

Shannon Cross
Thank you very much. I wanted to dig a bit more into the issues on the sales side and how they sort of came to the forefront and obviously what you are doing to mitigate them. But then also just want to think about as you go through and really revamp your sales structure and collapse level that you talked about during the Analyst Day. What are you doing to make sure that you don't see softness in revenue around that shift? Thank you.

Meg Whitman
Yes, good question. During Q4, we moved aggressively from the design phase of HPE Next to the execution phase of HPE Next, and we are very focused on minimizing disruption particularly with the sales team, but other areas as well. We are leveraging a lot of the best practices that enabled us to deliver our recent separations on time, on budget, it was the divestiture management office approach or the separation management approach.

In Q4, we've already begun implementing the sales changes, I mean those are done actually we started in November 1st, with a lot of changes, but we did a lot of changes in Q4 as well. We dismantled actually the region overhead structure, we refocused our sales force, we put more specialists in the field and we saw no impact to frontline sales from those changes that we made in Q4. That gives us confidence. They started November 1st, firing on all cylinders with the new organization and with a couple of months under their belt. We feel pretty good about that. I would say the storage challenge in the US was largely around not enough specialists in the field and frankly we need more scale in our storage sales here and combining Nimble and 3PAR under Keegan Riley, I think is going to really help here.

Shannon Cross
Okay, and the…

Tim Stonesifer
Radically simplified our comp plans. We went from say 400s or so type of comp plans down to 25 core plans or so, folks will be much focused, and we simplified that. We think that will be helpful as well.

Meg Whitman
And lastly Shannon, I would say we didn't talk about it much, but Hurricane Harvey disrupted our supply chain in a reasonably dramatic fashion. Tim mentioned, it was $93 million of cost to recover from Hurricane Harvey and that does not include Puerto Rico. We had to divert a lot of our Houston manufacturing to Europe and then airfreight those products back into the United States. We have announced that we are no longer going to be manufacturing in Houston, any US required manufacturing will be done in Chippewa Falls, Wisconsin, and then we are redistributing our manufacturing to locations around the world. That was another part of some weakness in Q4. The good news is, we go into Q1 with a nice backlog, because we just simply couldn't turn the supply chain on a dime. We have got a really nice backlog going into Q1.

Shannon Cross
Okay, thank you. And then Tim, can you just talk a little bit about maybe the progression of margins as we think about 2018, you said backend loaded. But I am just kind of curious given all the cost-cutting we have done now and that how we should really think about the ramp, and do you think you can get back to some of the more historical levels when we get towards the end of the year? Thank you.

Tim Stonesifer
Yes, I think we feel very good about the 11% to 12% in '18. We will be low in Q1 if you go from Q4 to Q1 we have typical seasonality. If you go back to '17 or '16 or '15 and look at the EGOP, you will see some of that seasonality. The other thing that you have will be, when we took out that $200 million of $300 million of costs in the second half of last year not all of that was run-rate. Although we will see cost savings going forward when you compare Q4 to Q1 we will be a little bit lighter. Q1 margins will be still pressured, but then as you go forward, again, if you look at that $250 million of cost savings as I said earlier roughly two-thirds of that or so is in the second half. You can load it up that way.

The M&A, again, as we continue to right-size the cost envelopes of that, that will continue to progress as we go out through the course of the year. The next point as we continue to grow Aruba all-flash, high-performance compute and those product lines become a heavier mix, we should get a natural lift. We would expect to see Q1 margins somewhat pressured, but those will continue to improve throughout the course of the year and wound up in the 11% to 12% range.

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

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

Jim Suva
Thank you very much. First a question for Antonio, then a question for Tim, and I will kind of ask them at the same time. Antonio since you had a very tough….

Company Representative
We just have Meg and Tim on the call [multiple speakers].

Jim Suva
I guess given his very prevalent stage time, is it fair to say that internally the strategy of HP is what we heard from you, Meg at the Investor Day or sometimes with the leadership change they

say hey, we had the HPE Next program now [technical difficulty] and HPE Next 2 program or something like that? And the question for Tim is, on financial services that went up a lot and can you help us understand about that? I think it was up over 20% year-over-year. Yet you talked about volumes relatively consistent, are you offering more advantageous terms or how do we connect the dots of what's going on there with that financial services?

Meg Whitman
Yes, let me answer the strategy question. The strategy will remain entirely consistent. It was crafted by Antonio and I, he has been leading HPE Next. I don't think he is going to lead another one in terms of reinventing that. We are completely aligned on the strategy. As is the sales team, as is the entire organization, and by the way it's working, you can see it working in the field. You can expect that entirely consistent strategy from Antonio.

Tim Stonesifer
And as far as financial services goes that 22% was driven by two things. We did have a large one-time lease buyout, as well as the fact that we have a heavier mix of operating leases as compared to last year. That's really what's driving the 22%. If you strip those two items out to get a more normalized view, we have about 1% growth. But that business continues to perform well. We are growing and that was our sixth consecutive quarter. If you look at our loss ratios and our remarketing capabilities, the team is doing a nice job.

Jim Suva
Thanks so much for the details, that's greatly appreciated.

Andrew Simanek
Great, thank you, Jim. Can we go on to the next question, please?

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

Steve Milunovich
Thank you. My two questions would be, first of all for Tim. Can you quantify the impact on gross margin from the higher commodity costs during the year and the NAND you had some issues earlier in the year, just getting enough NAND for storage, is that no longer an issue. Second for Meg, maybe you could just kind of step back and think about over your tenure at HPE. What you have heard that's different from customers, both in terms of how they think about their investing and technology and also how they view HPE?

Tim Stonesifer
Okay, on the commodity cost 10% lift if it holds for the course of the year again assuming the same pricing dynamics is probably a couple hundred million dollars. over the course of the year, and as far as NAND goes we have had some supply constraint earlier in the year those are fairly minimal now, and there have been some limited price increases there, but not to the extent of the memory.

Meg Whitman
Yes, what I would say is that HPE is a whole lot more relevant to customers and partners then it was. This was an enormous conglomerate and you would go in front of customers he would be talking PCs, Superdome Integrity X servers, Enterprise Services, Software and they weren't sure what we stood for, and it was just way too broad and we were not executing with the right R&D against any of those segments. Now HPE is more relevant, they know what we stand for. And the core value proposition is the software defined data center on-pram with public cloud like economics. This whole moved to flexible capacity and a pay-per-use model is actually encouraging people to say, you know, do I need to move every workload to the public cloud.

And then our New Stack offering, our New Stack announcement at Discover next week, I think it's going to be a milestone and a cap stone in some ways to the innovation and agenda that we've driven over the last six years. I would say that those are the main things, I would also say the speed at which we move. This company was a slower company then I would have like to see six years ago, and now we jump on opportunities, and jump on problems, it's far more nimble, far more agile. I think you frankly just a better run company than it was six years ago.

Andrew Simanek
Perfect. Thanks, Steve. Can we go to the next question, please?

Operator
Our next question is from Amit Daryanani with RBC Capital Markets. Please go ahead.

Amit Daryanani
Hi, thanks a lot. Good afternoon, guys. I guess couple of questions from me as well. When I look at the fiscal '18 guide, which you guys are talking about the Q1, historically Q1 is kind of about 20% to 23% of full year EPS. This time I think the implication is about 17.5%. It seems like a much more back end loaded year than normal. Could you just talk about what other lever that give you comfort that back half will be so much better, and is it all really around the restructuring initiative, is it different levers of growth vector that you have in the back half that give you confidence here?

Tim Stonesifer
Yes, again I will go back to two things. As far as looking at last year's seasonality as an example, it's a little bit skewed because of one, the memory costs increase. Remember last year that increase didn't happen until call at the latter part of January. Whereas when you look at this year, we have a full year impact or full quarter impact of that elevated DRAM costs pressure.

I think the biggest driver is HPE Next. When you look at that $250 million of cost savings, again roughly two thirds of that is in the back half of the year. The reason that is, when we are doing this clean sheet exercise, we are being very thoughtful as to, 1) how can we implement this correctly, and then 2) how do we minimize business disruption? if you think as an example, the simplification of the regional structure, the reducing the platform, the SKU rationalization, that does take a little time to work through because we want to make sure we get that right. We minimize any business disruption, that's really the primary driver along with the M&A that I spoke about and some of the other things, but the HPE Next is the big driver.

Meg Whitman
Yes, and I think you mentioned it, but just at the end there, but it's important to note that a number of these acquisitions when we acquired them were actually losing money, and we have now worked that of, and I think virtually all of them will be accretive in 2018.

Amit Daryanani
That's really helpful. If I just follow-up on the storage side, maybe I missed it. But could you quantify how much of a headwind or how much revenues will be you left on the table, because of some of the go-to-market challenges that you alluded to and the timeline to resolve it, you think it's done in 90 days or is it a bit more of a longer timeframe?

Meg Whitman
I don't think we will quantify that on this call. What I would say is, I think the sales team is hitting the ground running on storage. Phil Davis, who is our new Head of Sales, comes from a storage background. I think he will naturally see him pivot harder to storage than perhaps some of our earlier sales leaders. You will see improvement in the US, and by way, we did very well in EMEA, very well in APJ. You will see an improvement in the US in the storage space.

Amit Daryanani
Thank you.

Andrew Simanek
Great. Thanks, Amit. Next question, please.

Operator
Our next question comes from Lou Miscioscia with Pivotal Research Group. Please go ahead.

Lou Miscioscia
Okay, thank you. Meg. Maybe if you could just mention to us what you are planning to do with all your extra time and maybe not mention that you will spend more time with family. Specifically, any chance or do you have a restriction from going to a competitor? I have a follow-up.

Meg Whitman
First of all, I am going to work with Antonio through the transition at the end of January and then I will be a very active board member. actually after a 35 year non-stop career, I have actually going to take a little downtime, but there is no chance, I am going to a competitor, no chance. Listen, I have to say I become quite loyal to Hewlett Packard and to Hewlett Packard Enterprise, I love this company and I would never go to a competitor.

Lou Miscioscia
Okay. Then my follow-up to hit on, I guess storage again. I am obviously very familiar with the analyst meeting that you just had, and that you have had. Nimble has done very well. But when you look at the product line, I think its much more block associated not as much unstructured and then structured data is really where the majority of the growth is. I am just wondering, is it really a sales problem or do you actually possibly have to add more products to the product line and/or possibly do another acquisition?

Meg Whitman
The storage business is benefiting from the explosion of data, and we are seeing that every single day. We are also benefiting by storage becoming embedded in server architecture. InfoSight, is going to be a major game changer for our storage business is part of the reason that Nimble is growing at 80%, because it's AI for the storage arrays in a way that does predictive analytics and predictive maintenance.

With regard to acquisitions, when I came to this company we had a somewhat less than stellar reputation on acquisitions. The acquisition profile that had been successful for us, whether it's Aruba or SimpliVity, et cetera is the following. Is there a complementary technology to one that we already own that can benefit by leveraging our distribution channel? Listen Aruba has accelerated its growth rate under HP because we can introduce the Aruba product line to customers. They had no way to get into before and also customers tell me every day that they buy Aruba because it's not a standalone small startup company, it's backed by big HP from a service perspective, from a warranty perspective et cetera.

Those are the kind of acquisitions that we look at. If we found something that we thought was important in the storage business that benefited from our distribution channel, and we saw a good business case and it was priced right. We might think about doing it. You have seen Tim and I be much disciplined about acquisitions, returns based by the company right and have a very clear business case, whether it's cost take-out or acceleration. I promise you that Antonio and Tim will continue that disciplined approach to acquisitions. I will be on the board to make sure they do.

Andrew Simanek
Perfect. Thanks, Lou. I think we have time for one last question, please.

Operator
Our last question comes from Tim Long with BMO Capital Markets. Please go ahead.

Tim Long
Thank you. Just move to the networking business for a little bit, two here. First on the campus switching side, it's obviously done really well the last few quarters and the synergies with Aruba have helped. Could you talk a little bit about Cisco's new product portfolio with kind of the pay as you go model? What impact do you think that will have on that business will it be an opportunity for you? Will it move your business to more recurring revenue models as well? Secondly, if you could just update us on the data center piece and how the partnership with Arista is going? Thank you.

Meg Whitman
You're right. Aruba, both wired and wireless, has had a really great fiscal year '17. The thesis when we bought Aruba was the wireless would actually drag along the wired and that has actually turned out to be the case, particularly in the United States, where the wired portfolio had a great '17 in a particularly strong Q4. Increasingly, we see demand for Aruba on a flexible capacity model. Just like any other product that we sell, we are happy to do a flexible capacity model pay as you go, annuity based revenue stream for people who want to buy that way for Aruba.

We also I think are benefiting from the Gartner Magic Quadrant that I referred to or Tim referred to in the script where we are for the first time a leader in networking in the vision category and this is the first time in three decades that Cisco has not owned that top spot, and we can feel the momentum in the marketplace. a number of our competitors are talking about a clone of flex capacity when we dig into it, it is actually not the same thing as we are offering, it's not entwined with services and it's really just a sort of glorified leasing model and that's different from what we are offering. We think we have a competitive advantage.

With regard to Arista, so that partnership continues to go along. We are opening up our channel and our direct sales group to the data center opportunity. It's going along nicely. I think we can do better. At the moment, it's going along quite nicely, we are both pleased with where we are, but there could be more there.

Tim Long
Okay. Thank you.

Andrew Simanek
Great. Thanks, Tim. I think with that, we can wrap up today's call.

CONCLUSION

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