Hewlett Packard Enterprise

Q1 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

Antonio Neri - *President, Chief Executive Officer*

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

Andrew Simanek - *Vice President, Investor Relations*

PRESENTATION

Operator
Good day and welcome to the First Quarter 2021 Hewlett Packard Enterprise Earnings Conference Call. My name is Cole 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." And 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, Vice President of Investor Relations. Please proceed.

Andrew Simanek
Great, thank you. Good afternoon everyone, I'm Andy Simanek of Investor Relations for Hewlett Packard Enterprise. I'd like to welcome you to our fiscal 2021 first quarter earnings conference call with Antonio Neri, HPE's President and Chief Executive Officer and Tarek Robbiati, HPE's Executive Vice President and Chief Financial Officer.

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

As always, elements of this presentation are forward-looking and are based on our best view of the world and our businesses as we see them today. For more detailed information, please see the disclaimers on the earnings materials relating to forward-looking statements that involve risks, uncertainties, and assumptions. For a discussion of some of these risks, uncertainties, and assumptions, please refer to HPE's filings with the SEC, including its most recent Form 10-K and Form 10-Q. HPE assumes no obligation and does not intend to update any such forward-looking statements.

You may 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 quarterly report on Form 10-Q for the fiscal quarter ended January 31st, 2021. Also for financial information that has been expressed on a non-GAAP basis, we have provided reconciliations to the comparable GAAP information on our website. Please refer to the tables and slide presentation accompanying today's earnings release on our website for details.

Throughout this conference call, all revenue growth rates, unless noted otherwise, are presented on a year-over-year basis and adjusted to exclude the impact of currency. Also, please refer to our recently filed Form 8-K for detailed information on our realigned financial results for fiscal year '19 and fiscal year '20 to account for changes to our reporting structure in fiscal year '21 that better align to market trends and more accurately reflect how we are managing the business today.

Finally, after Antonio provides his high level remarks, Tarek will be referencing the slides and our earnings presentation throughout his prepared remarks. As mentioned, the earnings presentation can be found posted to our website and is also embedded within the webcast player for this earnings call.

With that, let me turn it over to Antonio.

Antonio Neri
Well, thanks, Andy, and good afternoon, everyone. Thank you for joining us today. And I hope you and your families continue to be safe and healthy. It is hard to comprehend everything that has transpired around the world over the last year.

The world we knew pre-pandemic has changed forever and the need to use innovative technologies to advance the way people live and business operates has never been greater. Improving the health of our communities from educating our children to digitizing our economy and enable its recovery creates an enormous opportunity. I believe we are entering a new era, the age of insight, fueled by the amount of data around us.

The arrival of safe and effective COVID-19 vaccines is a marvel of innovation and good news for us all, bringing hope and optimism for what lies ahead. I am personally very excited about the future of innovation and the impact it will have.

I am very pleased with HPE's Q1 results. Our revenue exceeded our outlook and represents a stronger than normal sequential seasonality. We significantly expanded our gross and operating margins, driving strong profitability across our businesses ahead of pre-pandemic levels. Our non-GAAP earnings per share exceeded the high-end of our guidance and free cash flow was a record Q1 performance. These results give us confidence to raise our fiscal year '21 EPS and free cash flow outlook, which we will address in more detail later on the call.

The global pandemic has brought a renewed focus on digital transformation as businesses are rethinking everything from remote work and collaboration to business continuity and data insights. As the world recovers, our customers are looking for the agility and simplicity of the cloud-native world with the flexibility and control of a hybrid business model. This is where we have a unique and differentiated value proposition. HPE acted intentionally and quickly last year to become a more agile organization and enable our ability to innovate faster.

Our Q1 results demonstrate our progress in enhancing our position to accelerate what comes next for our customers. I am very grateful for our dedicated, passionate, and resilient team members. They have been laser-focused on delivering for our customers and executing our strategy to drive long-term sustainable profitable growth for our shareholders. We are strengthening our core businesses, doubling down in key areas of growth, and accelerating our as-a-service pivot to become the edge-to-cloud platform-as-a-service choice for our customers and partners.

Our total revenue of $6.8 billion was down 3% from the prior year. When normalized for the backlog from last quarter, this is better than expected sequential seasonality. We saw solid order linearity intake across all of our businesses throughout the quarter. We are executing on multiple growth opportunities and we are particularly pleased with strong revenue growth in our Intelligent Edge business and growth in our as-a-service orders and revenue.

Going forward, we expect to see gradual improvement in customer spending as we progress through fiscal year '21 giving us the confidence in our ability to deliver on our long-term revenue growth guidance.

Importantly, our non-GAAP gross margin of 33.7% is up 30 basis points year-over-year and 300 basis points sequentially. Our non-GAAP operating profit of 11.3% is up 130 basis points year-over-year and our non-GAAP EPS of $0.52 is up 4% year-over-year and significantly above the high-end of our outlook.

We generated a record Q1 free cash flow of $563 million, the highest achieved in the first fiscal quarter in the history of Hewlett Packard Enterprise. These are impressive results made possible through disciplined execution, strong expense management, and critical investment prioritization. Based on the strong start to fiscal year ’21, we are raising our fiscal year ’21 non-GAAP EPS outlook to $1.70 to $1.88 and free cash flow to $1.1 billion to $1.4 billion.

Tarek will discuss the financial results and outlook in greater detail but let me first give you some additional context around our business segment performance and innovation highlights for the quarter. To emerge and recover from the global pandemic, enterprises require secure connectivity, data insight, and a cloud experience to accelerate their digital transformation, all of which further reinforces the significance of HPE’s differentiated edge-to-cloud platform-as-a-service vision.

In our prioritized areas of growth, our Intelligent Edge business had an outstanding quarter with revenue of $806 million, up 11% year-over-year. We again expect to take market share in both campus switching and wireless LAN segments of the market. We are seeing continued traction from our investment at the edge include rich software capabilities like our Aruba ClearPass security, our cloud-native Aruba Central, and most recently Aruba ESP, our edge services platform. Our Aruba SaaS revenue grew triple-digits year-over-year. The first full quarter following our Silver Peak acquisition reinforces that we are on track to grow high-margin recurring revenue with technology that accelerates our ability to capture the high-growth SD-WAN market opportunity.

Our Silver Peak SaaS offering provides customers the ability to connect all their edges and all their clouds in a fully automated and autonomous way. We launched new SD-WAN capabilities to centrally monitor, manage, and automate connectivity from branch location to AWS, adding support for the AWS Transit Gateway Connect solution. And early today, you may have seen our announcement introducing new solutions from deeper integration between our Aruba ESP and Microsoft Azure, which will simplify IoT device connectivity and bring Aruba Central to Microsoft Azure.

Finally, we introduced a new class of cloud-native and fully automated data center switching products specifically designed for the edge cloud data centers, which represents a $12 billion TAM expansion opportunity for Hewlett Packard Enterprise. These new offerings also enable us to accelerate the delivery of workload optimized solutions for our HPE GreenLake Cloud Services offering. Aruba’s innovations are why customers like Santander, Skechers USA and L3 Harris are choosing Aruba. We have multi-growth drivers in our Intelligent Edge business and we believe we are well positioned to outgrow the market.

High Performance Compute and Mission Critical Solutions is inherently a lumpy business due to the timing of deals and customer acceptances, because we can only recognize revenues once customer workloads are in production. In Q1, revenue was down 9% from the prior year. We remain very confident in this high-growth segment, based on our backlog of our awarded business, which now exceeds well over $2 billion of exascale contracts and a robust pipeline of multi-million dollar size deals. We are on track to deliver the 8%-to-12% annual growth rate communicated at our Security Analyst Meeting last fall.

We have a market-leading and differentiated portfolio of technologies that will power the new age of insight. We recently introduced HPE GreenLake cloud services for HPC to accelerate enterprise mainstream adoption of high performance computing, targeting a $3 billion to $4 billion TAM. Enterprises are running analytics on increasingly large data sets and are adopting new techniques, such as artificial intelligence, deep learning, and machine learning and they now will have access to HPC technologies that were historically out of reach.

In Q1, we won two major HPC awards, one with the National Center for Atmospheric Research, a contract worth $35 million to build a supercomputer for extreme weather research and another that expands NASA's HPE Aiken supercomputer. We also completed the installation of the Dammam 7 supercomputer for Saudi Aramco, which immediately became one of the Top 10 supercomputers in the world.

Finally, on February 20th, you may have seen that HPE's Spaceborne Computer-2 was launched into orbit for use on the International Space Station. The system is enabling real-time data processing with advanced commercial edge computing in space for the first time as NASA prepares for future missions.

Today, I want to share the news that Peter Ungaro has decided to leave the company in April. Pete joined HPE with Cray, with the Cray acquisition and ensured the successful integration of the two companies. He has made significant contribution and has grown the business, despite the complications and backlog brought by the global pandemic last year. Peter will stay on with the company in a consulting capacity for six months and I'm really grateful to him for his leadership.

I am pleased to announce that Justin Hotard, a seasoned HPE leader, will take over the leadership of the HPC MCS business and also Hewlett-Packard Labs reporting to me. Justin has brought an extensive experience across the company that includes leading our HPE Compute business, where he transformed the x86 compute portfolio and delivered revenue growth, profitability, and market share expansion. I'm excited about what Justin will bring to the business.

In the core businesses of Compute and Storage, our strategy to grow in profitable segments and pivot to more as-a-service solutions is paying off. We drove strong profitability and cash flow in both businesses. In Compute, our operating margins of 11.5% increased 80 basis points year-over-year and 490 basis points quarter-over-quarter. Our revenue declined 2% from the prior year but was up low-single digit sequentially when normalized for the backlog in Q4. We are encouraged by the sequential growth in new orders intake considering our normal Q2 seasonality.

Just last week, we launched our new HPE 5G Open RAN Solution Stack for telecommunications companies to accelerate the commercial adoption of Open RAN in 5G network deployments. This is a transformative technology, featuring the industry's first server-optimized for 5G Open RAN workloads with our HPE ProLiant Servers. This complements the HPE 5G Core Stack and build last year in March. Orange, one of the world's largest mobile network operators, is currently working with HPE to test a full 5G Core Stack in preparation for broader commercial deployment.

In Storage, revenue was down 6% from the prior year with operating margins of 19.7%, which is above the target profitability range we discussed at SAM. We continue to see strong revenue growth in our own IP software defined portfolio where we have been investing. Our HPE Primera business grew triple-digits year-over-year and soon will be bigger than our 3PAR business. This is the fastest revenue ramp ever achieved in our HPE Storage portfolio.

Our overall HPE All Flash Array portfolio grew 5%, driven by both HPE Primera and HPE Nimble Storage. Our hyperconverged strategy continued to gain traction. Our HPE Nimble dHCI next-generation technology powered with artificial intelligence give customers a cloud-native experience in their own data centers, where they also had the ability to control costs while maintaining data compliance and security.

Our focus on our own IP software-defined portfolio also improves our ability to attach rich services to our product offerings. Our storage operational services attach intensity is up double-digits year-over-year. We're also integrating cloud-native software technology to empower our field and accelerate sales velocity.

Just last week, we completed the acquisition of CloudPhysics. This deal provides us with a SaaS-based tool that analyzes IT environments to provide a quick return on investment recommendations for cloud migrations, application modernization, and infrastructure. I am very excited about this new addition to our set of capabilities, which will expand across our entire HPE portfolio.

Our pivot to as-a-service continues its strong momentum. Our annualized revenue run rate of $649 million was up 27% year-over-year and we had our highest first quarter ever with HPE GreenLake Cloud Services. Customer adoption continues to be very strong. In Q1, we gained more than 70 new HPE GreenLake Cloud Services logos.

Lineas, Europe's largest private rail freight operator selected HPE GreenLake Cloud Services to support its transformation from a conventional freight company into a high-performing, efficient, and sustainable transport system for the European logistics industry. We remain very confident in our unique approach and differentiated portfolio to capitalize on the rapidly growing on-premises as-a-service market.

Our new HPE Ezmeral Software portfolio and our HPE GreenLake Managed Services offerings enable a true consumption-based experience. Our HPE GreenLake Cloud Services customer retention rates are above 95% and the average customer usage of our cloud services currently are running at 120% of original commitment driven by customer expansion in their capacity utilization. We are excited about this long-term opportunity and are very confident in our 30% to 40% CAGR target by fiscal year '22. HPE continued to benefit from capabilities and services to enable growth in our core business segments.

HPE Pointnext Operational services had a solid quarter. Order trends are improving and revenue has stabilized to flat year-over-year with expanded operating profit margins. HPE Financial Services provides significant value to our customers as they rebuild and rethink their IT transformation requirements. Q1 revenue stabilized with improved collections to deliver a return on equity of 16.5%. Overall, I'm pleased with how we started fiscal year '21. Because of our strong start, we are raising our outlook for both EPS and free cash flow.

I talk to customers and partners almost every day, and while there continues to be some level of uncertainty, one thing is clear, customers are looking to accelerate their transformations and need a partner with the right technology, expertise, and financial flexibility. Our distinctive and industry-leading portfolio of edge-to-cloud solutions and unique capabilities is resonating with customers and I believe our team is one of the best in the industry. I'm impressed with our team members' commitment to make bold moves and ensuring we stay true to our purpose.

For the third year in a row, HPE has been named one of the World's Most Ethical Companies by the Ethisphere Institute. And just last week, HPE received the Thomson Reuters Foundation's Stop Slavery Enterprise Award for our leadership in limiting the risk of slavery in our supply chain and operations. With this unstoppable team and our portfolio-leading solutions, we are well-positioned to capture the tremendous opportunity ahead in fiscal year '21 and beyond.

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

Tarek Robbiati
Thank you very much, Antonio. I'll start with a summary of our financial results for the first quarter of fiscal year '21. As usual, I'll be referencing the slides from our earnings presentation to guide you through our performance in the quarter.

Antonio discussed the key highlights for this quarter on Slide 1, and now let me discuss our financial performance and KPIs starting with Slide 2. I am delighted to report that our Q1 results were marked by continued momentum in revenue, substantial gross and operating margin expansion, and robust cash generation.

We delivered Q1 revenues of $6.8 billion, down 3% from the prior year period, but better than our typical historical sequential seasonality, when normalizing for Q4 backlog. I am particularly proud of the fact that our non-GAAP gross margin returned to above pre-pandemic levels and was up 30 basis points from the prior year period and up 300 basis points sequentially. This was driven by strong pricing discipline, the absence of backlog-related headwinds, cost takeouts, and an ongoing favorable mix shift towards higher margin, software rich offerings.

Our operating expenses decreased year-over-year, thanks to our ongoing structural efficiency measures, as well as, some timing-related benefits related to hiring in key selected areas, which have been pushed out.

Our non-GAAP operating margin was 11.3%, up 130 basis points from the prior year, which translates to an 11% year-over-year increase in operating profit. As a result of our strong execution, we ended the quarter with non-GAAP EPS of $0.52, which was up 4% from the prior year and significantly above the higher end of our outlook range.

Q1 cash flow from operations was close to $1 billion, driven by better profitability and strong operational discipline, as well as, working capital timing benefits. Q1 free cash flow was $563 million, which was up approximately $750 million from the prior year and a record level for any first HPE first quarter. Finally, we paid $155 million of dividends in the quarter and are declaring a Q2 dividend today of $0.12 per share payable in April 2021.

Now, let's turn to our segment highlights on Slide 3. In Intelligent Edge, we accelerated our momentum with rich software capabilities delivering 11% year-over-year growth, our third consecutive quarter of sequential growth.

Switching was up 5% year-over-year with double-digit growth in North America and wireless LAN was up 11% year-over-year with double-digit growth in both North America and APJ. Additionally, the Aruba SaaS offering was up triple-digits year-over-year and is now a significant contributor to HPE overall ARR. Based on our solid performance, we expect to take share again this quarter in both campus switching and wireless LAN.

We are also seeing the significant operating profit potential of this business with operating margins in Q1 of 18.9%, up 680 basis points year-over-year as we drove greater productivity from past investments and operational leverage benefits kick-in.

Finally, I am pleased to say we recognized our first full quarter of revenue from the acquisition of Silver Peak, the premium growth SD-WAN leader, which contributed approximately 500 basis points to the Intelligent Edge top line growth.

In HPC & MCS, revenue declined 9% year-over-year, primarily due to the inherent lumpiness of the business, which is linked to the timing of deals and customer acceptance milestones. We remain very confident in the near term and longer term outlook for this business and are reaffirming our full year and three year revenue growth CAGR target of 8% to 12% respectively as highlighted at SAM.

We have an extremely strong order book of over $2 billion worth of awarded exascale contracts with another $5 plus billion of market opportunity over the next three years. Finally, we announced the launch of our HPC-as-a-Service offer, which we expect to gain traction later this year and become a further contributor to our overall growing ARR profile.

In Compute, revenue stabilized to a 2% year-over-year decline, but was up low single-digit sequentially when normalizing for Q4 backlog, which attest of a strong order momentum in the quarter.

Gross and operating margins were up meaningfully quarter-over-quarter due to the absence of any backlog-related margin impact, improved supply chain execution, and the rightsizing of the cost structure of the segment. We ended the quarter with an operating profit margin of 11.5%, up 80 basis points from the prior year period, and at the high end of our long term margin guidance for this segment provided at SAM.

Within Storage, revenue declined 6% year-over-year driven by difficult prior year compare, but with strong growth in software defined offerings. We are extremely well positioned in Storage with Primera and Nimble dHCI, our most software rich platforms. They are both growing triple-digits year-over-year. They are absolute winners in the market and Primera is on track to surpass 3PAR sales as early as next quarter. We also saw notable strength in overall Nimble, up 31% year-over-year and total All Flash Arrays were up 5% year-over-year. The mix shift towards our more software-rich platforms helped drive Storage operating profit margins to 19.7%, well above our long term outlook for this segment presented at SAM last October.

With respect to Pointnext Operational services including Nimble services, revenue stabilized and was flat year-over-year, driven by the increased focus of our BU segment on selling product and services as bundles, improve services intensity and our growing as-a-service business, and…which I remind you involves service attach rates of 100%. This is very important to note because all of our services…all of our OS revenue is recurring with three year average contract length and OS remains the highest operating margin contributor to our segments.

Within HPE Financial Services, revenue stabilized and was slightly down 1% year-over-year. As expected, we are seeing sequential improvements in our bad debt loss ratios ending this quarter at approximately 0.9%, which continues to be best-in-class within the industry. We have also seen strong cash collections well above pre-COVID levels.

As a result, our non-GAAP operating margin was 9.8%, up 110 basis points on the prior year and our return on equity is back to a pre-pandemic high-teens level of 16.5%.

Slide 4, highlights key metrics of our growing as-a-service business. Similar to last quarter, we are making great strides in our as-a-service offering this quarter with over 17 new GreenLake logos added in Q1. I am very pleased to report that our Q1 ’21 ARR came in at $649 million, representing 27% year-over-year reported growth. Total as-a-service orders were up 26% year-over-year, driven by very strong performance in Europe and Japan.

Our HPE Aruba Central SaaS platform also continued to grow revenue strong triple-digits year-over-year. Based on strong customer demand and recent wins, I am very happy with how this business is executing and progressing towards achieving its ARR growth target of 30% to 40% CAGR from fiscal year ’20 to fiscal year ’23, which I am reiterating today.

Slide 5 highlights our revenue and EPS performance to-date where you can clearly see the strong rebound from our Q2 trough. Revenue returned back to near pre-pandemic levels last quarter and with the operational execution of our cost optimization and resource allocation program, we have nearly doubled EPS from the trough and are now growing year-over-year.

Turning to Slide 6, we delivered a non-GAAP gross margin rate in Q1 of 33.7% of revenues, which was up 300 basis points sequentially and 30 basis points from the prior year period. This was driven by strong pricing discipline, the absence of backlog-related headwinds we had in the second half of last year, operational services, margin expansion from cost take out and automation, and a positive mix shift towards high margin software-rich businesses like the Intelligent Edge and Storage.

Moving to Slide 7, you can also see we have expanded non-GAAP operating profit margins, which is up 280 basis points sequentially and 130 basis points on the prior year period. We have done this by driving further productivity benefits while simultaneously maintaining our investment levels in R&D and field selling costs, which are critical to fuel our innovation engine and revenue growth targets. Q1 operating expenses also benefited from delayed hiring and a push out of select investments that we will be making to drive further growth.

Turning to Slide 8, we generated record levels of first quarter cash flows. Cash flow from operations was approximately $1 billion and free cash flow was $563 million for the quarter, up approximately $750 million from the prior year period. This was primarily driven by the increased profitability, strong operational discipline, and some working capital and in year timing related benefits.

Now, moving on to Slide 9, let me remind everyone about the strength of our diversified balance sheet, liquidity position, which are a competitive advantage in the current environment. As of our January 31st quarter end, we had approximately $4.2 billion of cash on hand. Together, with an undrawn revolving credit facility of $4.75 billion at our disposal, we currently have approximately $9 billion of liquidity.

Finally, I would like to reiterate that we remain committed to maintaining our investment grade credit rating, which was recently reaffirmed by the rating agencies. Bottom line, our improved free cash flow outlook and cash position ensures we have ample liquidity to run our operations, continue to invest in our business to drive growth, and execute on our strategy.

Now, turning to outlook on Slide 10. At our October 2020 Securities Analyst Meeting, we provided our outlook for fiscal year ’21, which we raised by $0.03 at the midpoint to $1.60 to $1.78 in our last earnings release. Today, I am pleased to announce that we are raising our fiscal year guidance for fiscal year ’21 once again to reflect our strong operational performance to-date and confidence in our outlook.

We now expect to grow our fiscal year ’21 non-GAAP operating profit by over 20% and expect to deliver fiscal year ’21 non-GAAP diluted net earnings per share between $1.70 to $1.88, which is a $0.10 per share improvement on the midpoint of our prior EPS guidance of $1.60 to $1.78.

From a top line perspective, we are pleased with the momentum we saw in Q1, and whilst we continue to see gradual improvement, we remain prudent as we and the rest of the world continue to navigate the pandemic and related macro uncertainties. More specifically for Q2 ’21, we expect revenue to be slightly better than in line with our normal sequential seasonality of down mid-single-digits from Q1. This still represents double-digit year-over-year growth from the $6 billion trough of Q2 of fiscal year ’20.

Now, with respect to supply chain, I would like to remind everyone that we exited Q4 of fiscal year ’20 with higher levels of inventory to protect against the risk of a short term supply squeeze and addressed improved customer demand. With these actions and other proactive steps that we’ve taken in Q1, we do not expect any meaningful impacts on our supply chain in the near term. We’re now turning our attention to working on strengthening our inventory supply for the second half of fiscal year ’21 as we see improved levels of demand, recognizing also that we have entered an inflationary environment for memory components.

For Q2 ’21, we expect GAAP diluted net EPS of $0.02 to $0.08 and non-GAAP diluted net EPS of $0.38 to $0.44. Additionally, given our record levels of cash flow this quarter and raised earnings outlook, I am very pleased to announce that we are also raising fiscal year ’21 free cash flow guidance from our SAM guidance of $900 million to $1.1 billion to a revised outlook of a $1.1 billion to $1.4 billion, a $250 million increase at the midpoint.

So overall, Antonio and I are proud of these results. We have navigated well through unprecedented challenges in the last fiscal year and have started the new fiscal year strong out of the gate.

We saw significant acceleration and customer demand in our Intelligent Edge business and the order pipeline in our HPC MCS business remains robust. Our core business of Compute and Storage revenues are stabilizing with improved margins and our as-a-service ARR continues to show strong momentum aligned to our outlook.

As a result of our cost optimization and resource allocation program, we are emerging from an unprecedented crisis as a different company, one that is much leaner, better resourced and positioned to capitalize on the gradual economic recovery currently at play. We are already seeing the benefits of our actions in our improved margin profile and free cash flow outlook.

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

Andrew Simanek
First question, please. Thank you.

QUESTION AND ANSWER

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

Our first question today will come from Shannon Cross with Cross Research. Please go ahead.

Shannon Cross
Thank you very much for taking my question. I'm curious, everyone is talking about digital transformations and they seem to have really gained traction early in COVID with the need for remote work. But now, could you talk a bit about how customer priorities and purchase decisions are changing as we're moving past COVID? And I'm wondering if it's an opportunity for more consultative sales and higher ASPs and margin. If you could talk about it maybe by segment, that would be helpful, because I assume it may vary across your business lines. Thank you.

Andrew Simanek
Thanks Shannon. Yes.

Antonio Neri
Well, thanks, Shannon. Yes, I will take that, Andy. Well, we definitely still see the tailwind of what we saw in 2020. Obviously, we work in a much more distributed environment, we talked about this all the time, about the fact that many employees will never return to the office, and they need access to data and services in a very connected way. And so, that's why we believe our Aruba business is a digital transformation engine for our customers. It is not just about access to a WiFi port, but it's also the fact that provides that edge-to-cloud connectivity for all the apps and data, wherever they live.

So, what we see though is an acceleration for definitely the access to data, the analytics side. We see AI machine learning taking hold of every segment of the market, because data insights are necessary to compete in this new digital economy. We see, obviously, the need to improve IT resiliency, based on the learnings we had in 2020. We see also the need to deploy cloud everywhere. And remember, our definition of the cloud is an experience, not a destination. And that's why we are very bullish about our HPE GreenLake cloud services.

The pipeline, the size of the deal, the need to engage in a consultative application-driven conversation is increasing. And that's where we have aligned our Advisory and Professional Services to that part of the business. So, I think there is going to be a mix of things, Shannon. But ultimately, digital transformation is no longer a priority. It is a strategic imperative. And those who move fast around the data insights and digitizing everything will be the winners. No question.

Andrew Simanek
Perfect, Great. Thank you, Shannon. Operator, can we go to the next question, please?

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

Wamsi Mohan
Yes, thank you, and congrats on the nice execution and especially the strong cash flow performance. Antonio, you noted some solid order linearity. I was wondering if you can talk about any meaningful changes that you're seeing in your customer conversations around recovery and enterprise demand. And what are some of the key assumptions around the upside to the EPS and cash flow guide? Thank you.

Antonio Neri
Well, maybe I'll start, and then I would let Tarek talk about the EPS upside. Listen, I spend more than 50% of my time talking to customers and partners. And I see a renewed focus on making sure the businesses are positioned for success. Definitely, there is a need to modernize their infrastructure and deploy these new technologies across the board. Our order linear intake, Wamsi, it was very solid every single week of the quarter. There was no one week that was higher than others. Honestly, I was very pleasantly surprised about that. The way I manage the business with my team, a quarter has 13 weeks, because when you go into a quarter, you already have a week of backlog and then you drive your linearity from there. And it was very consistent. It was across all businesses.

As Tarek said, our Compute business saw sequential growth in our order intake, the same in our areas of the Storage portfolio, where we are pivoting, particularly everything that's software-defined. Aruba was very strong out of the gate, and we see the momentum going through 2021, GreenLake, the same thing. But ultimately, our vision of edge-to-cloud is paying off, because ultimately customers need an architecture and a set of services that they can deliver what they need in this digital transformation. So, we feel very confident about that, and that's why we are confident in raising the outlook, which Tarek gave you the insights about the EPS upside. So maybe, Tarek, you want to talk about that?

Tarek Robbiati
Sure, Antonio. Wamsi, thanks for the question. We feel very good about our guidance for the second quarter and the full year '21. We did express in our scripts that we see our non-GAAP operating profit growing by over 20% year-over-year, and our guidance reflects that. Now, when you look at our margins for this quarter and the need to proceed with select investments, we feel that the guidance that we have on an EPS level is achievable, particularly when you look at the improvement quarter-over-quarter in Q2 and for the rest of the year, as Q3 and Q4 are usually strong quarters for our businesses, such as the Intelligent Edge and also Storage.

With respect to cash flow, our guidance has improved by $250 million at the midpoint, and it's a reflection of the improved outlook on operating profit. I am very pleased to put forward the guidance of $1.1 billion to $1.4 billion in free cash flow. And we'll see as the year progresses, how this guidance will translate in actual results.

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

Operator
And our next question will come from Aaron Rakers with Wells Fargo. Please go ahead.

Aaron Rakers
Yes. Thanks for taking the question. Also congrats on the quarter from me as well. I want to ask about the margin profile. Tarek, when you think about the performance that we've seen this last quarter, and you think about the mix of the business going forward. I guess, how do you think about the continued upward levers on gross margin? And can you just remind us of where we stand on the $800 million net savings initiatives from an OpEx perspective? Where we stand at now and what's left in terms of that target by the exit of fiscal '22? Thank you.

Tarek Robbiati
Sure, Aaron. Thank you for the questions. So, let's pick up gross margin first, and then we'll talk about our cost optimization, resource allocation program.

On gross margin, we feel very good that…now that we've put behind us all the effects from backlog in Q3, Q4 of last year. We're now operating the business in the context where we have normal business flows between orders and supply chain delivery. And we do acknowledge, like we said before, that there is an inflationary environment on some commodities such as DRAM, but we feel that we have the right levers around pricing and also purchases to navigate the upcoming quarters. We feel very good about our supply chain position in terms of inventory levels for the short term.

As a reminder, at the end of last year, we stocked up in anticipation of two things -- a resurgence in customer demand, which we saw happening and also a potential squeeze in some commodities that we were anticipating back then, which is proving true now. But we are very well-positioned to drive that. So, we will navigate the short term supply demand equation reasonably well, pulling on pricing levers as needed in our core.

In addition to this, you have a mixed effect from software rich revenues. These are coming from storage, and of course, the Intelligent Edge. Aruba is performing extremely well. It's a very high gross margin business. We see continued growth in Aruba. We've demonstrated three quarters of consecutive growth. This is set to continue. The products are in very hot demand everywhere globally. And the mix effect will also play on the gross margin front. I think, I've given you sufficient color there. So, maybe it's time we turn to the cost optimization and resource allocation program.

The bottom line on this one is we're on track, and the reason why you see our operating margins up to the levels that you've seen north of 11% overall for the company is because of that program. And so, what's very, very important for us is that we keep that expense discipline to sustain this level of operating profit growth moving forward and drive productivity, meaning having higher revenue over the same cost base to continue to drive operating profit growth and, therefore, translating into free cash flow growth moving forward. The $800 million net run rate benefits, as a reminder, would be felt for the most part in fiscal year '21. You started seeing some of that. We're incurring restructuring costs to that effect. And the program will be over by fiscal year '22. And we're well on track, and I'm very pleased with how it's tracking as we speak.

Antonio Neri
My other comment on…sorry, and my other comment on what Tarek said, what we announced last year in Q2 was the right thing to do. It gave…we have enough experience in this company to tell us to take actions immediately, and now proven to be very, very fruitful for us. As Tarek said in his remarks, right, we are becoming a different company, leaner, more agile and allows

us to prioritize investment in the areas of growth. So very pleased that we took that action at the time.

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

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

Katy Huberty
Thank you. My congrats on the quarter as well. Question for Tarek, you beat the first quarter by about $0.11 versus consensus. You guided up the full year by $0.10. So, the guidance implies that you don't operationally beat the next three quarters. Is that just prudence as we await full visibility into the pace of demand recovery or is that tied to some of the delayed OpEx investments that you mentioned? And maybe if you can detail what some of those investments are, just so that we can understand what those are. Thank you.

Tarek Robbiati
Sure. So we pretty much, Katy, passed on to the full-year guidance the entire beat in Q1. A couple of points on the investment front. You could see from some of the slides that we put forward, our investment in R&D and FSC, this has to continue, and we will find adequate sources to fund investments in FSCs and R&D, because we have to continue to fuel growth. And this is part of our story, which is to rethink our cost structure in terms of back-office and front of house to drive growth and innovation by way of software. So, I feel pretty good about that.

With respect to also your modeling of EPS on a full-year basis, I want to take the opportunity to highlight what's going on at the OI&E level. OI&E was a positive contributor to EPS in this quarter. This is just simply due to timing, particularly the contribution of economic interest from HPC. For the full year, we still see overall in OI&E a $100 million expense. And this is why you may think that the guidance is flat H1 on H2. But don't forget the effect of OI&E coming in, in the second half of the year as an expense.

Andrew Simanek
Great. Thanks Katy, for the question. Can we go to the next one, please?

Operator
And our next question will come from Amit Daryanani with Evercore. please go ahead.

Amit Daryanani
Thanks for taking my question. And I'll extend my congratulations as well. I wanted to talk a little bit on Aruba, fairly strong double-digit growth over here. And I think that's fairly impressive, given peers like Cisco and Juniper are probably seeing low to mid single-digit growth. I know Silver Peak got some element to this. But I'd love to get a sense from a share gain perspective, where are you seeing the share gains on the products and vertical side, some color there would be helpful. And then the durability of this growth, that would be helpful to understand as well.

Antonio Neri
Well, thanks, Amit. Well, listen, we believe Aruba is a winner, simply put. It is a software asset that delivers mobile first class, first experience that provides ubiquitous, secure connectivity in a

platform-oriented approach. So, for us, it's not a surprise to see the momentum in that business, which is not just revenue. As Tarek said, three consecutive quarters of growth, but also five quarters of growth and margin expansion in that business. And as we commented early on, our SaaS revenue, which is the subscription to the platform is up triple digits, right, on that part of the business. We expect to gain both shares in campus switching and wireless LAN, where there is…we'll see how the market does. But, some of our competitors don't disclose numbers. So, it's hard to understand what was down versus up, but I think the market was not as positive as people portray.

But we outperformed the market quite significantly. So, whether it's 100 basis points, 200 basis points or we would see soon. But I remain very bullish; I remain very bullish about the business. This business will continue to grow for the balance of the year, also because now we have Silver Peak in our portfolio, which is a completely differentiated experience for the SD-WAN. And remember what I said early on, in an edge-to-cloud architecture, you have to connect all your edges and all your cloud. And the only way to do it at scale is through software.

And Silver Peak brings a SaaS solution and also an on-prem solution that allows customers to connect all their edges on the cloud in a fully automated and autonomous way. And that's a big opportunity for us. And that's why I'm really bullish, because ultimately, we are integrating that solution into the same platform. And then, there are multiple drivers of growth as we think about the next 12, 24, 36 months, which includes edge computing and 5G. So, that's why I'm very, very confident in our ability to deliver against that market.

Andrew Simanek
Great. Thank you. Thanks, Amit, for the question. Can we go to the next one, please?

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

Simon Leopold
Thanks for taking the question. I wanted to see if maybe you could help us understand where you see your market in terms of enterprises coming out of the pandemic or recovery. And really, the root of this question is Intelligent Edge looks like it's recovered with the year-over-year growth, whereas the other segments, maybe we can expect more of a recovery pattern later this year. So, I'm looking for maybe a bridge between what's execution and what's macro recovery by segment? Thank you.

Antonio Neri
Yes. I mean, I think the market in general is recovering. As I said early on, Simon, is my point about the order linearity was steady and consistent throughout the quarter, which gives us the confidence that we will see gradual continued improvement in the demand. And it's not one business. I think it's across all businesses. And I think it's a combination of our execution, because of our strategy and the emphasis on the innovation that we bring to the market. And obviously, as the market gets better, we should take advantage of that. But remember, we have a unique value proposition. We are a company that has a unique portfolio from edge to cloud. Our competitors don't have all of that. Some have in one area; some have in another area. And what customers want is an integrated experience more and more.

And obviously, the shift to a consumption-driven model is in our favor because once we land a customer in GreenLake, basically, they get what they want, whether it's at the edge or it's in the core or whether it's in managed services for the hybrid model that they are all adopting. So, I think Compute, I think there are new technologies coming online with NVMe and more options that can be attached. Storage, obviously, is all the software-defined that Tarek talked about. Data is exploding.

And HPC, I'm very bullish about HPC, because ultimately, the data sets we see in customer sites continue to grow. And they all need AI machine learning at some point in time. Not just few customers. So, whether it's large public sector, education also is going to be very good because we expect our children to get back to school at some point in time. Obviously, transportation with autonomous vehicles and 5G deployment. So, I see multiple growth areas going forward and obviously, it's in our hand to innovate and deliver against that opportunity.

Tarek Robbiati
Antonio, if I can add color to compute business, I think it's important we let everyone on the call know, that when you look at the underlying performance of Compute and particularly when you normalize for Q4 backlog impacts, both AUP and units were up sequentially. So, there is a real recovery in Compute if you strip out the impact of backlog in Q4. AUP was up high single digits, and units were up approximately 10% quarter-on-quarter, once you do that normalization. It's very hard for analysts outside the company to do the normalization, but that's why I wanted to make the point. So hopefully, that will resonate with the analyst's community on this earnings announcement.

Andrew Simanek
Yes. Thanks, Tarek. And thanks…and thank you, Simon, for the question. So we're just about at the top of the hour now. Operator, can we have the last question, please?

Operator
And our last question today will come from Paul Coster with JP Morgan. Please go ahead.

Paul Coster
Not a very exciting question to finish up on, but it looks like you're pushing the upper boundary of your expected operating margin range for the core businesses. And I'm wondering…and it sounds like they could get better yet. So, are you going to change the range of expectations around operating margins? Or is this just sort of unsustainable what we're seeing at the moment?

Antonio Neri
Tarek, you want to take that?

Tarek Robbiati
Yes. I'll take it. Paul, this is a very exciting question. It's a very exciting question for me. It's essential. So, don't be shy about it. I would simply say, look, we have to keep the expense discipline and drive productivity. We feel that the upper boundary has yet to be tested. And I would say that this is always, in a company like this, not a short-term endeavor, but something that has to be done on the sustainable business…on a sustainable basis moving forward. But remember also that what drives the operating margin is the continuous expansion into software, margin-risk software offerings, and our ARR will start to shine as it continues to accelerate into fiscal year '21 and '22.

Andrew Simanek
Great. Thanks, Paul, for the question. Antonio, maybe I'll turn it over to you for any final comments you have before we close the call.

CONCLUSION

Antonio Neri
Well, thank you, Tarek, and thank you, everyone, for joining us today. I know there are more questions, but I know Tarek and the team will get off-line with you on the one-on-one follow-up calls. Now, I mean, I just want to reiterate, this is a very solid start for our company for fiscal year '21. Obviously, we remain committed to driving shareholder value.

I'm particularly pleased with our results in profitability, in free cash flow, which was record-breaking. The fact that we are confident in the demand recovery and our own execution that allows us to raise guidance for the full year in both non-GAAP EPS and free cash flow. We see tremendous momentum in our areas of innovations and focus, Intelligent Edge and even HPC business, remember with our lumpiness of the business, confident to deliver that 8%-to-12% growth and in the pivot to as-a-Service.

So, because all of that, we believe this is going to be a good year in balance. And obviously, we're all watching the trends with the COVID. But I think customers realize that this is the year they need to make the investments to digitize everything in their company. So again, thank you for joining us today and I hope you continue to stay safe and healthy. Talk to you next quarter.

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