HEWLETT PACKARD CO
Form 10-K
December 18, 2007

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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended: October 31, 2007**

**Or**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to**
**Commission file number 1-4423**

# HEWLETT-PACKARD COMPANY

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware**<br>(State or other jurisdiction of incorporation or organization) | **94-1081436**<br>(I.R.S. employer identification no.) |
| **3000 Hanover Street, Palo Alto, California**<br>(Address of principal executive offices) | **94304**<br>(Zip code) |

Registrant's telephone number, including area code: **(650) 857-1501**

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common stock, par value $0.01 per share | New York Stock Exchange |
| Liquid Yield Option Notes due 2017 | |

**Securities registered pursuant to Section 12(g) of the Act:**

None

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes ý No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act) Yes o No ý

The aggregate market value of the registrant's common stock held by non-affiliates was $109,938,540,000 based on the last sale price of common stock on April 30, 2007.

The number of shares of HP common stock outstanding as of November 30, 2007 was 2,573,868,626 shares.

**DOCUMENTS INCORPORATED BY REFERENCE**

| **DOCUMENT DESCRIPTION** | **10-K PART** |
|---|---|
| Portions of the Registrant's notice of annual meeting of stockholders and proxy statement to be filed pursuant to Regulation 14A within 120 days after Registrant's fiscal year end of October 31, 2007 are incorporated by reference into Part III of this Report. | III |

**Hewlett-Packard Company**

**Form 10-K**

**For the Fiscal Year Ended October 31, 2007**

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**Forward-Looking Statements**

*This Annual Report on Form 10-K, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7, contains forward-looking statements that involve risks, uncertainties and assumptions. If the risks or uncertainties ever materialize or the assumptions prove incorrect, the results of Hewlett-Packard Company and its consolidated subsidiaries ("HP") may differ materially from those expressed or implied by such forward-looking statements and assumptions. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including but not limited to any projections of revenue, margins, expenses, tax provisions, earnings, cash flows, benefit obligations, share repurchases or other financial items; any statements of the plans, strategies and objectives of management for future operations, including the execution of cost reduction programs and restructuring plans; any statements concerning expected development, performance or market share relating to products or services; any statements regarding future economic conditions or performance; any statements regarding pending investigations, claims or disputes; any statements of expectation or belief; and any statements of assumptions underlying any of the foregoing. Risks, uncertainties and assumptions include macroeconomic and geopolitical trends and events; the execution and performance of contracts by HP and its customers, suppliers and partners; the challenge of managing asset levels, including inventory; the difficulty of aligning expense levels with revenue changes; assumptions related to pension and other post-retirement costs; expectations and assumptions relating to the execution and timing of cost reduction programs and restructuring plans; the outcome of pending legislation and accounting pronouncements; the resolution of pending investigations, claims and disputes; and other risks that are described herein, including but not limited to the items discussed in "Risk Factors" in Item 1A of this report, and that are otherwise described or updated from time to time in HP's Securities and Exchange Commission reports. HP assumes no obligation and does not intend to update these forward-looking statements.*

## PART I

### ITEM 1. Business.

HP is a leading global provider of products, technologies, software, solutions and services to individual consumers, small- and medium-sized businesses ("SMBs") and large enterprises, including in the public and education sectors. Our offerings span:

- personal computing and other access devices,
- imaging and printing-related products and services,
- enterprise information technology infrastructure, including enterprise storage and server technology and software that optimizes business technology investments, and
- multi-vendor customer services, including technology support and maintenance, consulting and integration and outsourcing services.

HP was incorporated in 1947 under the laws of the State of California as the successor to a partnership founded in 1939 by William R. Hewlett and David Packard. Effective in May 1998, we changed our state of incorporation from California to Delaware.

**HP Products and Services; Segment Information**

During fiscal 2007, our operations were organized into seven business segments: Enterprise Storage and Servers ("ESS"), HP Services ("HPS"), HP Software, the Personal Systems Group ("PSG"), the Imaging and Printing Group ("IPG"), HP Financial Services ("HPFS") and Corporate Investments. Given the solution sale approach across our enterprise offerings, and in order to capitalize on up-selling and cross-selling opportunities, ESS, HPS and HP Software are structured beneath a broader

Technology Solutions Group ("TSG"). While TSG is not a business segment, this aggregation provides a supplementary view of our business. In each of the past three fiscal years, industry standard servers, desktops, notebooks and printing supplies each accounted for more than 10% of our consolidated net revenue.

A summary of our net revenue, earnings from operations and assets for our segments and business units is found in Note 18 to the Consolidated Financial Statements in Item 8, which is incorporated herein by reference. A discussion of factors potentially affecting our operations is set forth in "Risk Factors" in Item 1A, which is incorporated herein by reference.

***Technology Solutions Group***

TSG provides servers, storage, software and information technology ("IT") services that enable enterprise and midmarket business customers to better manage their current IT environments and transform IT into a business enabler. TSG products help accelerate growth, minimize risk and reduce costs to optimize the business outcomes of customers' IT investments. Companies around the globe leverage HP's infrastructure solutions to deploy next generation data centers and address business challenges ranging from compliance to business continuity. TSG's modular IT systems and services are primarily standards-based and feature differentiated technologies in areas including power and cooling, unified management, security, virtualization and automation. Each of the three business segments within TSG is described in detail below.

***Enterprise Storage and Servers***

The server market continues to shift towards standards-based architectures as proprietary hardware and operating systems are replaced by industry standard server platforms that typically offer compelling price and performance advantages by leveraging standards-based operating systems and microprocessor designs. At the same time, critical business functions continue to demand scalability and reliability. By providing a broad portfolio of storage and server solutions, ESS aims to optimize the combined product solutions required by different customers and provide solutions for a wide range of operating environments, spanning both the enterprise and the SMB markets. ESS provides storage and server products in a number of categories.

*Industry Standard Servers.* Industry standard servers include primarily entry-level and mid-range ProLiant servers, which run primarily Windows®,[1] Linux and Novell operating systems and leverage Intel Corporation ("Intel") and Advanced Micro Devices ("AMD") processors. The business spans a range of product lines that include pedestal-tower servers, density-optimized rack servers and HP's BladeSystem family of server blades. In fiscal 2007, HP's industry standard server business continued to lead the industry in terms of units shipped and factory revenue. HP also has a leadership position in server blades, the fastest-growing segment of the market.

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(1) Windows® is a registered trademark of Microsoft Corporation.

*Business Critical Systems.* Business Critical Systems include Itanium®[2]-based Integrity servers running on the HP-UX, Windows®, Linux and OpenVMS operating systems, including the high-end Superdome servers and fault-tolerant Integrity NonStop servers. Business Critical Systems also include the Reduced Instruction Set Computing ("RISC")-based servers with the HP 9000 line running on the HP-UX operating system, HP AlphaServers running on both Tru64 UNIX®[3] and OpenVMS, and MIPs-based NonStop servers.

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(2) Itanium® is a registered trademark of Intel Corporation.

(3) UNIX® is a registered trademark of The Open Group.

*Storage.* HP's StorageWorks offerings include entry-level, mid-range and high-end arrays, storage area networks, network attached storage, storage management software and virtualization technologies, as well as tape drives, tape libraries and optical archival storage.

***HP Services***

HPS provides a portfolio of multi-vendor IT services, including technology services, consulting and integration and outsourcing services. HPS also offers a variety of services tailored to particular industries such as communications, media and entertainment, manufacturing and distribution, financial services, health and life sciences and the public sector, including government services. HPS collaborates with the Enterprise Storage and Servers and HP Software groups, as well as with third-party system integrators and software and networking companies to bring solutions to HP customers. HPS also works with HP's Imaging and Printing Group and Personal Systems Group to provide managed print services, end user workplace services, and mobile workforce productivity solutions to enterprise customers.

*Technology Services.* HPS provides a range of technology services from standalone product support to high availability services for complex, global, networked, multi-vendor environments. This business also manages the delivery of product warranty support through its own service organization, as well as through authorized partners.

*Consulting and Integration.* HPS provides consulting and integration services to architect, design and implement technology and industry-specific solutions for customers. Consulting and integration also provides cross-industry solutions in the areas of architecture and governance, infrastructure, applications and packaged applications, security, IT service management, information management and enterprise Microsoft solutions.

*Outsourcing Services.* HPS offers a variety of IT management and outsourcing services that support customers' infrastructure, applications, business processes, end user workplace, print environment and business continuity and recovery requirements.

***HP Software***

HP Software provides a suite of Business Technology Optimization ("BTO") software solutions, including support, that allow customers to manage and automate their IT infrastructure, operations, applications, IT services and business processes under the OpenView brand. In addition, this segment delivers a suite of comprehensive, carrier-grade software platforms for developing and deploying next-generation voice, data and converged services to network and service providers under the HP OpenCall brand.

We are focused on extending our enterprise systems management leadership position into application, service management and business process management market segments. During fiscal 2007, we completed the acquisitions of Mercury Interactive Corporation, Bristol Technologies, Inc., SPI Dynamics, Inc. and Opsware Inc., which added transaction monitoring, applications security testing and data center automation capabilities to the BTO portfolio. We expect to continue to make strategic acquisitions as well as undertake internal realignments as we deem appropriate. The portfolio of BTO solutions is designed to enable our customers to reduce their IT costs, and gain better insight to their business and IT operations. This helps our customers align IT resources with their business goals and automate data center operations and IT processes, enabling IT to deliver more value to the business.

***Personal Systems Group***

PSG is the leading provider of personal computers ("PCs") in the world based on unit volume shipped and annual revenue. PSG provides commercial PCs, consumer PCs, workstations, handheld computing devices, digital entertainment systems, calculators and other related accessories, software and services for the commercial and consumer markets. We group commercial desktops, commercial notebooks and workstations into commercial clients and consumer desktop and consumer notebooks into consumer clients when describing our performance in these markets. Like the broader PC market, PSG continues to experience a shift toward mobile products such as notebooks. Both commercial and consumer PCs are based predominately on the Windows® operating system and use Intel and AMD processors.

*Commercial PCs.* PSG offers a variety of personal computers optimized for commercial uses, including enterprise and SMB customers, and for connectivity and manageability in networked environments. These commercial PCs include primarily the HP Compaq business desktops, business notebooks, and Tablet PCs.

*Consumer PCs.* Consumer PCs include the HP Pavilion and Compaq Presario series of multi-media consumer desktops and notebooks, as well as HP Media Center and Voodoo Gaming PCs, which are targeted at the home user.

*Workstations.* Workstations are individual computing products designed for users demanding enhanced performance, such as computer animation, engineering design and other programs requiring high-resolution graphics. HP provides workstations that run on UNIX®, Windows® and Linux-based operating systems.

*Handheld Computing.* HP provides a series of HP iPAQ Pocket PC handheld computing devices that run on Windows® Mobile software. These products range from value devices such as music or Global Positioning System receivers to advanced devices with voice and data capability.

*Digital Entertainment.* PSG's digital entertainment products are targeted at the intersection of the personal computing and consumer electronics markets and span a range of products and product categories that allow customers to enjoy a broad range of digital entertainment experiences. PSG's digital entertainment products include HD DVD and RW drives and DVD writers; plasma and LCD flat-panel televisions; and the HP Digital Entertainment Center, which allows consumers to access their music, movies, home videos and photos from a single device via remote control.

***Imaging and Printing Group***

IPG is the leading imaging and printing systems provider in the world for consumer and commercial printer hardware, printing supplies, printing media and scanning devices. IPG is also focused on imaging solutions in the commercial markets, from managed print services solutions to addressing new growth opportunities in commercial printing in areas such as industrial applications, outdoor signage, and the graphic arts business. When describing our performance in this segment, we group inkjet printer units and digital photography and entertainment products and services into consumer hardware, LaserJet printers and graphics and imaging products into commercial hardware and break out printer supplies separately.

*Inkjet Printers.* Inkjet systems include desktop single function and inkjet all-in-one printers, including photo, productivity and business inkjet printers and scanners.

*Digital Photography and Entertainment.* Digital imaging products and services include photo specialty printers, photo kiosks, digital cameras, accessories and online photo services through Snapfish. An important part of IPG's strategy is to provide digital imaging solutions that rival traditional imaging for quality, cost and ease of use so that consumers can manage their digital imaging throughout the home and outside the home. On November 7, 2007, we announced that we were seeking an alternative business model for our HP-branded cameras.

*LaserJet Printers.* LaserJet systems include monochrome and color laser printers, printer-based multi-function devices and Total Print Management Solutions for enterprise customers. A key initiative in this area of IPG's business has been and continues to be driving color printing penetration in the office.

*Graphics and Imaging.* Graphics and Imaging products include large format (DesignJet) printers, Indigo and Scitex digital presses, digital publishing solutions and graphics printing solutions. A key initiative for IPG is to capture high-value pages by developing compelling solutions for the industrial, commercial printing and graphics segments.

*Printer Supplies.* Printer supplies include LaserJet toner and inkjet cartridges and other printing-related media. These supplies include HP-branded Vivera and ColorSphere ink and HP Premium and Premium Plus photo papers, which are designed to work together as a system to produce faster prints with improved resistance to fading, increased print quality and better affordability.

***HP Financial Services***

HPFS supports and enhances HP's global product and service solutions, providing a broad range of value-added financial life-cycle management services. HPFS enables our worldwide customers to acquire complete IT solutions, including hardware, software and services. The group offers leasing, financing, utility programs and asset recovery services, as well as financial asset management services for large global and enterprise customers. HPFS also provides an array of specialized financial services to SMBs and educational and governmental entities. HPFS offers innovative, customized and flexible alternatives to balance unique customer cash flow, technology obsolescence and capacity needs.

***Corporate Investments***

Corporate Investments is managed by the Office of Strategy and Technology and includes Hewlett-Packard Laboratories, also known as HP Labs, and certain business incubation projects. Revenue in this segment is attributable to the sale of certain network infrastructure products, including Ethernet switch products that enhance computing and enterprise solutions under the brand ProCurve Networking. Corporate Investments also derives revenue from licensing specific HP technology to third parties.

**Sales, Marketing and Distribution**

We manage our business and report our financial results based on the principal business segments described above. Our customers are organized by consumer and commercial customer groups, and distribution is organized by direct and channel. Within the channel, we have various types of partners that we utilize for various customer groups. The partners include:

- retailers that sell our products to the public through their own physical or Internet stores;
- resellers that sell our products and services, frequently with their own value-added products or services, to targeted customer groups;
- distribution partners that supply our solutions to smaller resellers with which we do not have direct relationships;
- independent distributors that sell our products into geographies or customer segments in which we have little or no presence;
- original equipment manufacturers ("OEMs") that integrate our products with their own hardware or software and sell the integrated products;

independent software vendors ("ISVs") that provide their clients with specialized software products, frequently driving sales of additional non-HP products and services, and often assist us in selling our products and services to clients purchasing their products; and

systems integrators that provide various levels and kinds of expertise in designing and implementing custom IT solutions and often partner with HPS to extend their expertise or influence the sale of our products and services.

The mix of HP's business by channel or direct sales differs substantially by business and region. We believe that customer buying patterns and different regional market conditions necessitate sales, marketing and distribution to be tailored accordingly. HP is focused on driving efficiencies and productivity gains in both the direct and indirect business.

TSG manages enterprise and public sector customer relationships and also is charged with simplifying sales processes across our segments to improve speed and effectiveness of customer delivery. In this capacity, TSG manages our direct sales for both volume and value products including industry standard servers products, UNIX®, enterprise storage and software and pre-sales technical consultants, as well as our direct distribution activities for commercial products and go-to-market activities with systems integrators and ISVs. TSG also drives HP's vertical sales and marketing approach in the communication, media and entertainment, financial services, manufacturing and distribution and public sector industries.

PSG manages SMB customer relationships and commercial reseller channels, due largely to the significant volume of commercial PCs that HP sells through these channels. In addition to commercial channel relationships, the volume direct organization, which is charged with the management of direct sales for volume products, is hosted within PSG.

IPG manages HP's overall consumer-related sales and marketing activities, including our annual consumer product launch for the back-to-school and holiday seasons. IPG also manages consumer channel relationships with third-party retail locations for imaging and printing products, as well as other consumer products, including consumer PCs, which provides for a bundled sale opportunity between PCs and IPG products. In addition, IPG manages direct consumer sales online through HP Home & Home Office.

**Manufacturing and Materials**

We utilize a number of contract manufacturers ("CMs") and original design manufacturers ("ODMs") around the world to manufacture HP-designed products. The use of CMs and ODMs is intended to generate cost efficiencies and reduce time to market for certain HP-designed products. Third-party OEMs manufacture some products that we purchase and resell under the HP brand. In addition to our use of CMs and ODMs, we currently manufacture finished products from components and sub-assemblies that we acquire from a wide range of vendors.

We utilize two primary methods of fulfilling demand for products: building products to order and configuring products to order. We employ building products to order capabilities to maximize manufacturing efficiencies by producing high volumes of basic product configurations. Configuring products to order permits configuration of units to the particular hardware and software customization requirements of certain customers. Our inventory management and distribution practices in both building products to order and configuring products to order seek to minimize inventory holding periods by taking delivery of the inventory and manufacturing immediately prior to the sale or distribution of products to our customers.

We purchase materials, supplies and product subassemblies from a substantial number of vendors. For many of our products, we have existing alternate sources of supply, or such sources are readily available. However, we do rely on sole sources for laser printer engines, LaserJet supplies and parts for products with short life cycles (although some of these sources have operations in multiple locations). We are dependent upon Intel as a supplier of processors and Microsoft for various software products. However, we believe that disruptions with these suppliers would result in industry-wide dislocations and therefore would not disproportionately disadvantage us relative to our competitors. We also have a valued relationship with AMD, and we have continued to see solid acceptance of AMD processors in the market during fiscal 2007.

Like other participants in the high technology industry, we ordinarily acquire materials and components through a combination of blanket and scheduled purchase orders to support our requirements for periods averaging 90 to 120 days. From time to time, we experience significant price volatility and supply constraints of certain components that are not available from multiple sources. Frequently, we are able to obtain scarce components for somewhat higher prices on the open market, which may have an impact on gross margin but does not disrupt production. On occasion, we acquire component inventory in anticipation of supply constraints or enter into longer-term pricing commitments with vendors to improve the priority, price and availability of supply. See "Risk Factors We depend on third-party suppliers, and our revenue and gross margin could suffer if we fail to manage supplier issues properly," in Item 1A, which is incorporated herein by reference.

**International**

Our products and services are available worldwide. We believe this geographic diversity allows us to meet demand on a worldwide basis for both consumer and enterprise customers, draws on business and technical expertise from a worldwide workforce, provides stability to our operations, allows us to drive economies of scale, provides revenue streams to offset geographic economic trends and offers us an opportunity to access new markets for maturing products. In addition, we believe that future growth is dependent in part on our ability to develop products and sales models that target developing countries. In this regard, we believe that our broad geographic presence gives us a solid base upon which to build such future growth.

A summary of our domestic and international net revenue and net property, plant and equipment is set forth in Note 18 to the Consolidated Financial Statements in Item 8, which is incorporated herein by reference. Approximately 67% of our overall net revenue in fiscal 2007 came from outside the United States. The substantial majority of our net revenue originating outside the United States was from customers other than foreign governments.

For a discussion of risks attendant to HP's foreign operations, see "Risk Factors Due to the international nature of our business, political or economic changes or other factors could harm our future revenue, costs and expenses and financial condition," in Item 1A, "Quantitative and Qualitative Disclosure about Market Risk" in Item 7A and Note 9 to the Consolidated Financial Statements in Item 8, which are incorporated herein by reference.

**Research and Development**

We remain committed to innovation as a key element of HP's culture. Our development efforts are focused on designing and developing products, services and solutions that anticipate customers' changing needs and desires and emerging technological trends. Our efforts also are focused on identifying the areas where we believe we can make a unique contribution and the areas where partnering with other leading technology companies will leverage our cost structure and maximize our customers' experiences.

HP Labs, together with the various research and development groups within the five principal business segments, are responsible for our research and development efforts. HP Labs is part of our Corporate Investments segment.

Expenditures for research and development were $3.6 billion in each of fiscal years 2007 and 2006 and $3.5 billion in fiscal 2005. We anticipate that we will continue to have significant research and development expenditures in the future to provide a continuing flow of innovative, high-quality products and services to maintain and enhance our competitive position.

For a discussion of risks attendant to our research and development activities, see "Risk Factors  If we cannot continue to develop, manufacture and market products and services that meet customer requirements for innovation and quality, our revenue and gross margin may suffer," in Item 1A, which is incorporated herein by reference.

**Patents**

Our general policy has been to seek patent protection for those inventions and improvements likely to be incorporated into our products and services or where proprietary rights will improve our competitive position. At October 31, 2007, our worldwide patent portfolio included over 31,000 patents, which was slightly above the number of patents in our patent portfolio at the end of both fiscal 2006 and fiscal 2005.

Patents generally have a term of twenty years from the time they are filed. As our patent portfolio has been built over time, the remaining terms on the individual patents vary. While we believe that our patents and applications are important for maintaining the competitive differentiation of our products and maximizing our return on research and development investments, no single patent is in itself essential to us as a whole or any of our principal business segments.

In addition to developing our patents, we license intellectual property from third parties as we deem appropriate. We have also granted and continue to grant to others licenses under patents owned by us when we consider these arrangements to be in our interests. These license arrangements include a number of cross-licenses with third parties.

For a discussion of risks attendant to intellectual property rights, see "Risk Factors  Our revenue, cost of sales, and expenses may suffer if we cannot continue to license or enforce the intellectual property rights on which our business depends or if third parties assert that we violate their intellectual property rights," in Item 1A, which is incorporated herein by reference.

**Backlog**

We believe that backlog is not a meaningful indicator of future business prospects due to the large volume of products delivered from shelf or channel partner inventories, the shortening of product life cycles and the relative portion of net revenue related to our service and support businesses. Therefore, we believe that backlog information is not material to an understanding of our overall business.

**Seasonality**

General economic conditions have an impact on our business and financial results. From time to time, the markets in which we sell our products experience weak economic conditions that may negatively affect sales. We experience some seasonal trends in the sale of our products and services. For example, European sales often are weaker in the summer months and consumer sales often are stronger in the fourth calendar quarter. Demand during the spring and early summer months also may be adversely impacted by market anticipation of seasonal trends. See "Risk Factors  Our sales cycle makes planning and inventory management difficult and future financial results less predictable," in Item 1A, which is incorporated herein by reference.

**Competition**

We encounter aggressive competition in all areas of our business activity. We compete primarily on the basis of technology, performance, price, quality, reliability, brand, reputation, distribution, range of products and services, ease of use of our products, account relationships, customer training, service and support, security and availability of application software and our Internet infrastructure offerings.

The markets for each of our business segments are characterized by vigorous competition among major corporations with long-established positions and a large number of new and rapidly growing firms. Product life cycles are short, and to remain competitive we must develop new products and services, periodically enhance our existing products and services and compete effectively on the basis of the factors listed above. In addition, we compete with many of our current and potential partners, including OEMs that design, manufacture and often market their products under their own brand names. Our successful management of these competitive partner relationships will continue to be critical to our future success. Moreover, we anticipate that we will have to continue to adjust prices on many of our products and services to stay competitive.

On an overall basis we are among the largest U.S.-based companies offering our range of general purpose computers and personal information, imaging and printing products for industrial, scientific, business and consumer applications, and IT services. We are the leader or among the leaders in each of our principal business segments.

The competitive environments in which each segment operates are described below:

*Enterprise Storage and Servers.* The areas in which ESS operates are intensely competitive and are characterized by rapid and ongoing technological innovation and price reductions. Our competitors range from broad solutions providers such as International Business Machines Corporation ("IBM") to more focused competitors such as EMC Corporation and Network Appliance, Inc. in storage, Dell, Inc. ("Dell") in industry standard servers, and Sun Microsystems, Inc. in both industry standard and UNIX®-based servers. We believe that our important competitive advantages in this segment include the six technology components of our adaptive infrastructure initiatives: IT systems, power and cooling, security, management, virtualization and automation. We believe that our competitive advantages also include our global reach and our significant intellectual property portfolio and research and development capabilities, which will contribute to further enhancements of our product offerings and our ability to cross sell our portfolio and leverage scale advantages in everything from brand to procurement leverage.

*HP Services.* HPS competes in IT support services, consulting and integration and outsourcing services. The IT support services and consulting and integration markets have been under significant pressure as our customers have reduced their IT budgets. However, this trend has benefited the outsourcing services business as customers look at reducing IT management costs to enable more strategic investments. Our competitors include IBM Global Services, systems integration firms such as Accenture Ltd., outsourcing firms such as Electronic Data Systems Corporation, and offshore companies. We also compete with other traditional hardware providers, such as Dell, which are increasingly offering services to support their products. Many of our competitors are able to offer a wide range of global services, and some of our competitors enjoy significant brand recognition. HPS teams with many companies to offer services, and those arrangements allow us to extend our reach and augment our capabilities. Our competitive advantages are evident in our deep technology expertise, which includes multi-vendor environments, virtualization and automation, our strong track record of collaboration with clients and partners, and the combination of our expertise in infrastructure management with skilled global resources in SAP, Oracle and Microsoft platforms.

*HP Software.* Our software competitors include companies focused on providing software solutions for IT management, such as BMC Software Inc, CA Inc., and IBM Tivoli Software.

*Personal Systems Group.* The areas in which PSG operates are intensely competitive and are characterized by rapid price reductions and inventory depreciation. Our primary competitors for the branded personal computers are Dell, Acer Inc, Apple Inc., Lenovo Group Limited and Toshiba Corporation. In particular regions, we also experience competition from local companies and from generically-branded or "white box" manufacturers. Our competitive advantages include our broad product portfolio, our innovation and research and development capabilities, our brand and procurement leverage, our ability to cross sell our portfolio of offerings, our extensive service and support offerings and the availability of our broad-based distribution of products from retail and commercial channels to direct sales.

*Imaging and Printing Group.* We are the leading imaging and printing systems provider in the world for printer hardware, printing supplies and scanning devices. We believe that our brand recognition, reputation for quality, breadth of product offerings and large customer base are important competitive advantages. However, the markets for printer hardware and associated supplies are highly competitive, especially with respect to pricing and the introduction of new products and features. IPG's key competitors include Canon USA, Inc., Lexmark International, Inc., Xerox Corporation ("Xerox"), Seiko Epson Corporation, Samsung Electronics Co. Ltd. and Dell. In addition, independent suppliers offer refill and remanufactured alternatives for our supplies which, although generally offering lower print quality and reliability, may be offered at lower prices and put pressure on our supplies sales and margins. Other companies also have developed and marketed new compatible cartridges for HP's laser and inkjet products, particularly in jurisdictions outside of the United States where adequate intellectual property protection may not exist. In recent years, we and our competitors have regularly lowered prices on printer hardware both to reach new customers and in response to the competitive environment. Important areas for future growth include digital photography in the home and outside the home, printer-based multi-function devices in the office space, digital presses in our imaging and graphics space and driving color printing expansion in the office. While we encounter competitors in some product categories whose current market share is greater than ours, such as Xerox in copiers and Heidelberger Druckmaschinen Aktiengesellschaft in publishing, we believe we will provide important new contributions in the home, the office and publishing environments by providing comprehensive solutions.

*HP Financial Services.* In our financing business, our competitors are captive financing companies, mainly IBM Global Financing, as well as banks and financial institutions. We believe our competitive advantage in this business over banks and financial institutions is our ability to finance products, services and total solutions.

For a discussion of risks attendant to these competitive factors, see "Risk Factors The competitive pressures we face could harm our revenue, gross margin and prospects," in Item 1A, which is incorporated herein by reference.

**Environment**

Some of our operations use substances regulated under various federal, state, local and international laws governing the environment, including laws governing the discharge of pollutants into the air and water, the management and disposal of hazardous substances and wastes and the cleanup of contaminated sites. Many of our products are subject to various federal, state, local and international laws governing chemical substances in products, including laws regulating the manufacture and distribution of chemical substances and laws restricting the presence of certain substances in electronics products. We could incur substantial costs, including cleanup costs, fines and civil or criminal sanctions, third-party damage or personal injury claims, if we were to violate or become liable under environmental laws or if our products become non-compliant with environmental laws. We also face increasing complexity in our product design and procurement operations as we adjust to new and future requirements relating to the materials composition of our products, including the restrictions on lead, cadmium and certain other substances that apply to specified electronics products put on the market in the European Union (the "EU") as of July 1, 2006 (Restriction of Hazardous Substances Directive) and similar legislation in China, the labeling provisions of which went into effect March 1, 2007. We also could face significant costs and liabilities in connection with product take-back legislation. The EU has enacted the Waste Electrical and Electronic Equipment Directive, which makes producers of electrical goods, including computers and printers, financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. The deadline for the individual member states of the EU to enact the directive in their respective countries was August 13, 2004 (such legislation, together with the directive, the "WEEE Legislation"). Producers participating in the market became financially responsible for implementing their responsibilities under the WEEE Legislation beginning in August 2005. Implementation in certain EU member states was delayed into 2006 and 2007. Similar legislation has been or may be enacted in other jurisdictions, including in the United States, Canada, Mexico, China and Japan. It is our policy to apply strict standards for environmental protection to sites inside and outside the United States, even if we are not subject to regulations imposed by local governments. The liability for environmental remediation and other environmental costs is accrued when HP considers it probable and can reasonably estimate the costs. Environmental costs and accruals are presently not material to our operations or financial position, and we do not currently anticipate material capital expenditures for environmental control facilities.

**Executive Officers:**

**Mark V. Hurd; age 50; Chairman, Chief Executive Officer and President**

Mr. Hurd has served as Chairman of HP since September 2006 and as Chief Executive Officer, President and a member of the Board since April 2005. Prior to that, he served as Chief Executive Officer of NCR Corporation, a technology company, from March 2003 to March 2005 and as President from July 2001 to March 2005. From September 2002 to March 2003, Mr. Hurd was the Chief Operating Officer of NCR, and from July 2000 until March 2003 he was Chief Operating Officer of NCR's Teradata data-warehousing division.

**R. Todd Bradley; age 49; Executive Vice President, Personal Systems Group**

Mr. Bradley was elected Executive Vice President in June 2005. From October 2003 to June 2005, he served as the Chief Executive Officer of palmOne Inc., a mobile computing company. Mr. Bradley also served as President and Chief Operating Officer of palmOne from May 2002 until October 2003 and as Executive Vice President and Chief Operating Officer from June 2001 to May 2002.

**Charles N. Charnas; age 49; Vice President, Deputy General Counsel and Assistant Secretary**

Mr. Charnas was elected Assistant Secretary in 1999. He was appointed a Vice President and Deputy General Counsel in 2002. Since 1999, he has headed the Corporate, Securities and Mergers and Acquisitions Section of HP's worldwide legal department. From September 2006 until February 2007, Mr. Charnas also served as Acting General Counsel of HP. Mr. Charnas is not an executive officer for purposes of Section 16 of the Securities Exchange Act of 1934.

**Jon E. Flaxman; age 50; Executive Vice President and Chief Administrative Officer**

Mr. Flaxman has served as Executive Vice President and Chief Administrative Officer of HP since March 2007. Mr. Flaxman served as Senior Vice President and Controller from 2002 until March 2007, and as Principal Accounting Officer from February 2005 until March 2007.

**Michael J. Holston; age 45; Executive Vice President, General Counsel and Secretary**

Mr. Holston has served as Executive Vice President and General Counsel since February 2007 and as Secretary since March 2007. Prior to that, he was a partner in the litigation practice at Morgan, Lewis & Bockius LLP, where, among other clients, he supported HP as external counsel on a variety of litigation and regulatory matters for more than ten years.

**Vyomesh Joshi; age 53; Executive Vice President, Imaging and Printing Group**

Mr. Joshi was elected Executive Vice President in 2002 after serving as Vice President since January 2001. He became President of the Imaging and Printing Group in February 2001. Mr. Joshi also served as Chairman of Phogenix Imaging LLC, a joint venture between HP and Kodak, from 2000 until May 2003, when Phogenix was dissolved. Mr. Joshi also is a director of Yahoo! Inc.

**Catherine A. Lesjak; age 48; Executive Vice President and Chief Financial Officer**

Ms. Lesjak has served as Executive Vice President and Chief Financial Officer since January 2007. She served as Senior Vice President from 2003 until December 2006 and as Treasurer from 2003 until March 2007. From May 2002 to July 2003, she was Vice President of Finance for Enterprise Marketing and Solutions and Vice President of Finance for the Software Global Business Unit.

**Ann M. Livermore; age 49; Executive Vice President, Technology Solutions Group**

Ms. Livermore was elected Executive Vice President in 2002 after serving as Vice President since 1995. Since May 2004, she has led the Technology Solutions Group. In April 2001, she became President of HP Services. Ms. Livermore also is a director of United Parcel Service, Inc.

**John N. McMullen; age 49; Senior Vice President and Treasurer**

Mr. McMullen has served as Senior Vice President and Treasurer since March 2007. Previously, he served as Vice President of Finance for HP's Imaging and Printing Group since May 2002.

**Randall D. Mott; age 51; Executive Vice President and Chief Information Officer**

Mr. Mott was elected Executive Vice President and Chief Information Officer in July 2005. From 2000 to June 2005, Mr. Mott was Senior Vice President and Chief Information Officer of Dell, Inc., a technology company.

**James T. Murrin; age 47; Senior Vice President, Controller and Principal Accounting Officer**

Mr. Murrin has served as Senior Vice President, Controller and Principal Accounting Officer since March 2007. Previously, he served as Vice President of Finance for the Technology Solutions Group since 2004. Prior to that, Mr. Murrin was Vice President of Finance for HP Services and held various other finance positions at HP since joining the company in 1989.

**Marcela Perez de Alonso; age 53; Executive Vice President, Human Resources**

Ms. Perez de Alonso was elected Executive Vice President, Human Resources in January 2004. From 1999 until she joined HP in January 2004, Ms. Perez de Alonso was Division Head of Citigroup North Latin America Consumer Bank, in charge of the retail business operations of Citigroup in Puerto Rico, Venezuela, Colombia, Peru, Panama, the Bahamas and the Dominican Republic and also in charge of deposit products for the international retail bank until 2002.

**Shane V. Robison; age 54; Executive Vice President and Chief Strategy and Technology Officer**

Mr. Robison has served as Executive Vice President and Chief Strategy and Technology Officer since May 2002. He was elected Senior Vice President in 2002 in connection with the Compaq acquisition. Prior to joining HP, Mr. Robison served as Senior Vice President, Technology and Chief Technology Officer at Compaq from 2000 to May 2002.

**Employees**

We had approximately 172,000 employees worldwide as of October 31, 2007.

**Available Information and Exchange Certifications**

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available on our website at *http://www.hp.com/investor/home*, as soon as reasonably practicable after HP electronically files such reports with, or furnishes those reports to, the Securities and Exchange Commission. HP's Corporate Governance Guidelines, Board of Directors committee charters (including the charters of the Audit Committee, HR and Compensation Committee, and Nominating and Governance Committee) and code of ethics entitled "Standards of Business Conduct" also are available at that same location on our website. Stockholders may request free copies of these documents from:

Hewlett-Packard Company
Attention: Investor Relations
3000 Hanover Street
Palo Alto, CA 94304
(866) GET-HPQ1 or (866) 438-4771
http://www.hp.com/investor/informationrequest

We submitted the certification of the CEO of HP required by Section 303A.12(a) of the New York Stock Exchange "NYSE" Listed Company Manual, relating to HP's compliance with the NYSE's corporate governance listing standards, to the NYSE on March 19, 2007 with no qualifications.

We included the certifications of the CEO and the CFO of HP required by Section 302 of the Sarbanes-Oxley Act of 2002 and related rules, relating to the quality of HP's public disclosure, in this Annual Report on Form 10-K as Exhibits 31.1 and 31.2.

**ITEM 1A. Risk Factors.**

Because of the following factors, as well as other variables affecting our operating results, past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

*The competitive pressures we face could harm our revenue, gross margin and prospects.*

We encounter aggressive competition from numerous and varied competitors in all areas of our business, and our competitors may target our key market segments. We compete primarily on the basis of technology, performance, price, quality, reliability, brand, reputation, distribution, range of products and services, ease of use of our products, account relationships, customer training, service and support, security, availability of application software, and Internet infrastructure offerings. If our products, services, support and cost structure do not enable us to compete successfully based on any of those criteria, our operations, results and prospects could be harmed.

Unlike many of our competitors, we have a portfolio of businesses and must allocate resources across these businesses while competing with companies that specialize in one or more of these product lines. As a result, we may invest less in certain areas of our businesses than our competitors do, and these competitors may have greater financial, technical and marketing resources available to them than our businesses that compete against them. Industry consolidation also may affect competition by creating larger, more homogeneous and potentially stronger competitors in the markets in which we compete, and our competitors also may affect our business by entering into exclusive arrangements with existing or potential customers or suppliers.

We may have to continue to lower the prices of many of our products and services to stay competitive, while at the same time trying to maintain or improve revenue and gross margin. The markets in which we do business, particularly the personal computer and printing markets, are highly competitive, and we encounter aggressive price competition for all of our products and services from numerous companies globally. Over the past several years, price competition in the market for personal computers, printers and related products has been particularly intense as competitors have aggressively cut prices and lowered their product margins for these products. Our results of operations and financial condition may be adversely affected by these and other industry-wide pricing pressures.

Because our business model is based on providing innovative and high quality products, we may spend a proportionately greater amount on research and development than some of our competitors. If we cannot proportionately decrease our cost structure on a timely basis in response to competitive price pressures, our gross margin and therefore our profitability could be adversely affected. In addition, if our pricing and other factors are not sufficiently competitive, or if there is an adverse reaction to our product decisions, we may lose market share in certain areas, which could adversely affect our revenue and prospects.

Even if we are able to maintain or increase market share for a particular product, revenue could decline because the product is in a maturing industry. Revenue and margins also could decline due to increased competition from other types of products. For example, refill and remanufactured alternatives for some of HP's LaserJet toner and inkjet cartridges compete with HP's supplies business. In addition, other companies have developed and marketed new compatible cartridges for HP's LaserJet and inkjet products, particularly in jurisdictions outside of the United States where adequate intellectual property protection may not exist. HP expects competitive refill and remanufacturing and cloned cartridge activity to continue to pressure margins in IPG, which in turn has a significant impact on HP margins and profitability overall.

*If we cannot continue to develop, manufacture and market products and services that meet customer requirements for innovation and quality, our revenue and gross margin may suffer.*

The process of developing new high technology products and services and enhancing existing products and services is complex, costly and uncertain, and any failure by us to anticipate customers' changing needs and emerging technological trends accurately could significantly harm our market share and results of operations. We must make long-term investments, develop or obtain appropriate intellectual property and commit significant resources before knowing whether our predictions will accurately reflect customer demand for our products and services. After we develop a product, we must be able to manufacture appropriate volumes quickly and at low costs. To accomplish this, we must accurately forecast volumes, mixes of products and configurations that meet customer requirements, and we may not succeed at all or within a given product's life cycle. Any delay in the development, production or marketing of a new product could result in our not being among the first to market, which could further harm our competitive position.

In the course of conducting our business, we must adequately address quality issues associated with our products and services, including defects in our engineering, design and manufacturing processes, as well as defects in third-party components included in our products. In order to address quality issues, we work extensively with our customers and suppliers and engage in product testing to determine the cause of the problem and to determine appropriate solutions. However, we may have limited ability to control quality issues, particularly with respect to faulty components manufactured by third parties. If we are unable to determine the cause, find an appropriate solution or offer a temporary fix (or "patch"), we may delay shipment to customers, which would delay revenue recognition and could adversely affect our revenue and reported results. Finding solutions to quality issues can be expensive and may result in additional warranty, replacement and other costs, adversely affecting our profits. If new or existing customers have difficulty operating our products, our operating margins could be adversely affected, and we could face possible claims if we fail to meet our customers' expectations. In addition, quality issues can impair our relationships with new or existing customers and adversely affect our reputation, which could have a material adverse effect on our operating results.

*If we do not effectively manage our product and services transitions, our revenue may suffer.*

Many of the industries in which we compete are characterized by rapid technological advances in hardware performance and software features and functionality; frequent introduction of new products; short product life cycles; and continual improvement in product price characteristics relative to product performance. Among the risks associated with the introduction of new products and services are delays in development or manufacturing, variations in costs, delays in customer purchases or reductions in price of existing products in anticipation of new introductions, difficulty in predicting customer demand for the new offerings and effectively managing inventory levels so that they are in line with anticipated demand, risks associated with customer qualification and evaluation of new products and the risk that new products may have quality or other defects or may not be supported adequately by application software. If we do not make an effective transition from existing products and services to future offerings, our revenue may decline.

Our revenue and gross margin also may suffer due to the timing of product or service introductions by our suppliers and competitors. This is especially challenging when a product has a short life cycle or a competitor introduces a new product just before our own product introduction. Furthermore, sales of our new products and services may replace sales, or result in discounting of some of our current offerings, offsetting the benefit of even a successful introduction. There also may be overlaps in the current products and services of HP and portfolios acquired through mergers and acquisitions that we must manage. In addition, it may be difficult to ensure performance of new customer contracts in accordance with our revenue, margin and cost estimates and to achieve operational efficiencies embedded in our estimates. Given the competitive nature of our industry, if any of these risks materializes, future demand for our products and services and our results of operations may suffer.

*Our revenue, cost of sales, and expenses may suffer if we cannot continue to license or enforce the intellectual property rights on which our business depends or if third parties assert that we violate their intellectual property rights.*

We rely upon patent, copyright, trademark and trade secret laws in the United States and similar laws in other countries, and agreements with our employees, customers, suppliers and other parties, to establish and maintain our intellectual property rights in technology and products used in our operations. However, any of our direct or indirect intellectual property rights could be challenged, invalidated or circumvented, or such intellectual property rights may not be sufficient to permit us to take advantage of current market trends or otherwise to provide competitive advantages, which could result in costly product redesign efforts, discontinuance of certain product offerings or other competitive harm. Further, the laws of certain countries do not protect our proprietary rights to the same extent as the laws of the United States. Therefore, in certain jurisdictions we may be unable to protect our proprietary technology adequately against unauthorized third-party copying or use, which could adversely affect our competitive position.

Because of the rapid pace of technological change in the information technology industry, much of our business and many of our products rely on key technologies developed or licensed by third parties. We may not be able to obtain or to continue to obtain licenses and technologies from these third parties at all or on reasonable terms, or such third parties may demand cross-licenses to our intellectual property. In addition, it is possible that as a consequence of a merger or acquisition transaction third parties may obtain licenses to some of our intellectual property rights or our business may be subject to certain restrictions that were not in place prior to the transaction. Consequently, we may lose a competitive advantage with respect to these intellectual property rights or we may be required to enter into costly arrangements in order to terminate or limit these rights.

Third parties also may claim that we or customers indemnified by us are infringing upon their intellectual property rights. For example, in recent years, individuals and groups have begun purchasing intellectual property assets for the sole purpose of making claims of infringement and attempting to extract settlements from large companies such as HP. If we cannot or do not license the infringed technology at all or on reasonable terms or substitute similar technology from another source, our operations could suffer. Even if we believe that the claims are without merit, the claims can be time-consuming and costly to defend and divert management's attention and resources away from our business. Claims of intellectual property infringement also might require us to redesign affected products, enter into costly settlement or license agreements or pay costly damage awards, or face a temporary or permanent injunction prohibiting us from marketing or selling certain of our products. Even if we have an agreement to indemnify us against such costs, the indemnifying party may be unable to uphold its contractual agreements to us.

Finally, our results of operations and cash flows could be affected in certain periods and on an ongoing basis by the imposition, accrual and payment of copyright levies or similar fees. In certain countries (primarily in Europe), proceedings are ongoing against HP seeking to impose levies upon equipment (such as PCs, multifunction devices and printers) and alleging that the copyright owners are entitled to compensation because these devices enable reproducing copyrighted content. Other countries that do not yet have levies on these types of devices are expected to extend existing levy schemes, and countries that do not currently have levy schemes may decide to impose copyright levies on these types of devices. If imposed, the amount of copyright levies would depend on the types of products determined to be subject to the levy, the number of units of those products sold during the period covered by the levy and the per unit fee for each type of product, all of which may be affected by several factors, including the outcome of ongoing litigation involving HP and other industry participants and possible action by the legislative bodies in the applicable countries, but could be substantial. Consequently, the ultimate impact of these potential copyright levies or similar fees and the ability of HP to recover such amounts through increased prices, remains uncertain.

*Economic uncertainty could adversely affect our revenue, gross margin and expenses.*

Our revenue and gross margin depend significantly on general economic conditions and the demand for computing and imaging products and services in the markets in which we compete. Economic weakness and constrained IT spending has previously resulted, and may result in the future, in decreased revenue, gross margin, earnings or growth rates and problems with our ability to manage inventory levels and collect customer receivables. We could experience such economic weakness and reduced spending, particularly in our consumer and financial services businesses, due to increases in fuel and other energy costs, conditions in the residential real estate and mortgage markets, access to credit and other macroeconomic factors affecting spending behavior. In addition, customer financial difficulties have previously resulted, and could result in the future, in increases in bad debt write-offs and additions to reserves in our receivables portfolio, inability by our lessees to make required lease payments and reduction in the value of leased equipment upon its return to us compared to the value estimated at lease inception. We also have experienced, and may experience in the future, gross margin declines in certain businesses, reflecting the effect of items such as competitive pricing pressures, inventory write-downs, charges associated with the cancellation of planned production line expansion, and increases in pension and post-retirement benefit expenses. Economic downturns also may lead to restructuring actions and associated expenses. Uncertainty about future economic conditions makes it difficult for us to forecast operating results and to make decisions about future investments. Delays or reductions in information technology spending could have a material adverse effect on demand for our products and services, and consequently our results of operations, prospects and stock price.

*Due to the international nature of our business, political or economic changes or other factors could harm our future revenue, costs and expenses and financial condition.*

Sales outside the United States make up approximately 67% of our net revenue. Our future revenue, gross margin, expenses and financial condition also could suffer due to a variety of international factors, including:

- ongoing instability or changes in a country's or region's economic or political conditions, including inflation, recession, interest rate fluctuations and actual or anticipated military or political conflicts;
- longer accounts receivable cycles and financial instability among customers;
- trade regulations and procedures and actions affecting production, pricing and marketing of products;
- local labor conditions and regulations;
- managing a geographically dispersed workforce;
- changes in the regulatory or legal environment;
- differing technology standards or customer requirements;
- import, export or other business licensing requirements or requirements relating to making foreign direct investments, which could affect our ability to obtain favorable terms for components or lead to penalties or restrictions;
- difficulties associated with repatriating cash generated or held abroad in a tax-efficient manner and changes in tax laws; and
- fluctuations in freight costs and disruptions in the transportation and shipping infrastructure at important geographic points of exit and entry for our products and shipments.

The factors described above also could disrupt our product and component manufacturing and key suppliers located outside of the United States. For example, we rely on manufacturers in Taiwan for the production of notebook computers and other suppliers in Asia for product assembly and manufacture.

As approximately 67% of our sales are from countries outside of the United States, other currencies, particularly the euro and the Japanese yen, can have an impact on HP's results (expressed in U.S. dollars). Currency variations also contribute to variations in sales of products and services in impacted jurisdictions. In addition, currency variations can adversely affect margins on sales of our products in countries outside of the United States and margins on sales of products that include components obtained from suppliers located outside of the United States. We use a combination of forward contracts and options designated as cash flow hedges to protect against foreign currency exchange rate risks. Such hedging activities may be ineffective or may not offset more than a portion of

the adverse financial impact resulting from currency variations. Gains or losses associated with hedging activities also may impact our revenue and to a lesser extent our cost of sales and financial condition.

In many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by laws and regulations applicable to us, such as the Foreign Corrupt Practices Act. Although we implement policies and procedures designed to facilitate compliance with these laws, our employees, contractors and agents, as well as those companies to which we outsource certain of our business operations, may take actions in violation of our policies. Any such violation, even if prohibited by our policies, could have a material adverse effect on our business.

*Terrorist acts, conflicts and wars may seriously harm our business and revenue, costs and expenses and financial condition and stock price.*

Terrorist acts, conflicts or wars (wherever located around the world) may cause damage or disruption to HP, our employees, facilities, partners, suppliers, distributors, resellers or customers. The potential for future attacks, the national and international responses to attacks or perceived threats to national security, and other actual or potential conflicts or wars, including the ongoing military operations in Iraq, have created many economic and political uncertainties. In addition, as a major multi-national company with headquarters and significant operations located in the United States, actions against or by the United States may impact our business or employees. Although it is impossible to predict the occurrences or consequences of any such events, they could result in a decrease in demand for our products, make it difficult or impossible to deliver products to our customers or to receive components from our suppliers, create delays and inefficiencies in our supply chain and result in the need to impose employee travel restrictions. We are predominantly uninsured for losses and interruptions caused by terrorist acts, conflicts and wars.

*Business disruptions could seriously harm our future revenue and financial condition and increase our costs and expenses.*

Our worldwide operations could be subject to earthquakes, power shortages, telecommunications failures, water shortages, tsunamis, floods, hurricanes, typhoons, fires, extreme weather conditions, medical epidemics and other natural or manmade disasters or business interruptions, for which we are predominantly self-insured. The occurrence of any of these business disruptions could seriously harm our revenue and financial condition and increase our costs and expenses. Our corporate headquarters, and a portion of our research and development activities, are located in California, and other critical business operations and some of our suppliers are located in California and Asia, near major earthquake faults. The ultimate impact on us, our significant suppliers and our general infrastructure of being located near major earthquake faults is unknown, but our revenue, profitability and financial condition could suffer in the event of a major earthquake or other natural disaster. In addition, some areas, including California and parts of the East Coast, Southwest and Midwest of the United States, have previously experienced, and may experience in the future, major power shortages and blackouts. These blackouts could cause disruptions to our operations or the operations of our suppliers, distributors and resellers, or customers. Moreover, the consolidation of all of our worldwide IT data centers into six centers located in the southern United States, when completed, could increase the impact on us of a natural disaster or other business disruption occurring in that geographic area.

*If we fail to manage the distribution of our products and services properly, our revenue, gross margin and profitability could suffer.*

We use a variety of different distribution methods to sell our products and services, including third-party resellers and distributors and both direct and indirect sales to both enterprise accounts and consumers. Successfully managing the interaction of our direct and indirect channel efforts to reach various potential customer segments for our products and services is a complex process. Moreover, since each distribution method has distinct risks and gross margins, our failure to implement the most advantageous balance in the delivery model for our products and services could adversely affect our revenue and gross margins and therefore our profitability. Other distribution risks are described below.

Our financial results could be materially adversely affected due to channel conflicts or if the financial conditions of our channel partners were to weaken.
Our future operating results may be adversely affected by any conflicts that might arise between our various sales channels, the loss or deterioration of any alliance or distribution arrangement or the loss of retail shelf space. Moreover, some of our wholesale and retail distributors may have insufficient financial resources and may not be able to withstand changes in business conditions, including economic weakness and industry consolidation. Many of our significant distributors operate on narrow product margins and have been negatively affected by business pressures. Considerable trade receivables that are not covered by collateral or credit insurance are outstanding with our distribution and retail channel partners. Revenue from indirect sales could suffer, and we could experience disruptions in distribution if our distributors' financial conditions, abilities to borrow funds in the credit markets or operations weaken.

Our inventory management is complex as we continue to sell a significant mix of products through distributors.

We must manage inventory effectively, particularly with respect to sales to distributors, which involves forecasting demand and pricing issues. Distributors may increase orders during periods of product shortages, cancel orders if their inventory is too high or delay orders in anticipation of new products. Distributors also may adjust their orders in response to the supply of our products and the products of our competitors and seasonal fluctuations in end-user demand. Our reliance upon indirect distribution methods may reduce visibility to demand and pricing issues, and therefore make forecasting more difficult. If we have excess or obsolete inventory, we may have to reduce our prices and write down inventory. Moreover, our use of indirect distribution channels may limit our willingness or ability to adjust prices quickly and otherwise to respond to pricing changes by competitors. We also may have limited ability to estimate future product rebate redemptions in order to price our products effectively.

*We depend on third-party suppliers, and our revenue and gross margin could suffer if we fail to manage suppliers properly.*

Our operations depend on our ability to anticipate our needs for components, products and services and our suppliers' ability to deliver sufficient quantities of quality components, products and services at reasonable prices in time for us to meet critical schedules. Given the wide variety of systems, products and services that we offer, the large number of our suppliers and contract manufacturers that are dispersed across the globe, and the long lead times that are required to manufacture, assemble and deliver certain components and products, problems could arise in planning production and managing inventory levels that could seriously harm us. Other supplier problems that we could face include component shortages, excess supply, risks related to the terms of our contracts with suppliers, risks associated with contingent workers, and risks related to our relationships with single source suppliers, as described below.

*Shortages.* Occasionally we may experience a shortage of, or a delay in receiving, certain supplies as a result of strong demand, capacity constraints, supplier financial weaknesses, inability of suppliers to borrow funds in the credit markets, disputes with suppliers (some of which are also customers), other problems experienced by suppliers or problems faced during the transition to new suppliers. In particular, our PC business relies heavily upon Contract Manufacturers ("CMs") and Original Design Manufacturers ("ODMs") to manufacture its products and is therefore dependent upon the continuing operations of those CMs and ODMs to fulfill demand for our PC products. HP represents a substantial portion of the business of some of these CMs and ODMs, and any changes to the nature or volume of business transacted by HP with a particular CM or ODM could adversely affect the operations and financial condition of the CM or ODM and lead to shortages or delays in receiving products from that CM or ODM. If shortages or delays persist, the price of these supplies may increase, we may be exposed to quality issues or the supplies may not be available at all. We may not be able to secure enough supplies at reasonable prices or of acceptable quality to build products or provide services in a timely manner in the quantities or according to the specifications needed. Accordingly, our revenue and gross margin could suffer as we could lose time-sensitive sales, incur additional freight costs or be unable to pass on price increases to our customers. If we cannot adequately address supply issues, we might have to reengineer some products or service offerings, resulting in further costs and delays.

*Oversupply.* In order to secure supplies for the provision of products or services, at times we may make advance payments to suppliers or enter into non-cancelable commitments with vendors. In addition, we may purchase supplies strategically in advance of demand to take advantage of favorable pricing or to address concerns about the availability of future supplies. If we fail to anticipate customer demand properly, a temporary oversupply could result in excess or obsolete components, which could adversely affect our gross margin.

*Contractual terms.* As a result of binding price or purchase commitments with vendors, we may be obligated to purchase supplies or services at prices that are higher than those available in the current market and be limited in our ability to respond to changing market conditions. In the event that we become committed to purchase supplies or services for prices in excess of the current market price, we may be at a disadvantage to competitors who have access to components or services at lower prices, and our gross margin could suffer. In addition, many of our competitors obtain products or components from the same CMs, ODMs and suppliers that we utilize. Our competitors may obtain better pricing and other terms and more favorable allocations of products and components during periods of limited supply, and our ability to engage in relationships with certain CMs, ODMs and suppliers could be limited. The practice employed by our PC business of purchasing product components and transferring those components to its CMs and ODMs may create large supplier receivables with the CMs and ODMs that, depending on the financial condition of the CMs and ODMs, may have a risk of uncollectibility. In addition, certain of our CMs, ODMs and suppliers may decide in the future to discontinue conducting business with us. Any of these actions by our competitors, CMs, ODMs or suppliers could adversely affect our future operating results and financial condition.

*Contingent workers.* We also rely on third-party suppliers for the provision of contingent workers, and our failure to manage our use of such workers effectively could adversely affect our results of operations. We have been exposed to various legal claims relating to the status of contingent workers in the past and could face similar claims in the future. We may be subject to shortages, oversupply or fixed contractual terms relating to contingent workers, as described above. Our ability to manage the size of, and costs associated with, the contingent workforce may be subject to additional constraints imposed by local laws.

*Single source suppliers.* Our use of single source suppliers for certain components could exacerbate our supplier issues. We obtain a significant number of components from single sources due to technology, availability, price, quality or other considerations. For example, we rely on Intel to provide us with a sufficient supply of processors for many of our PCs, workstations, handheld computing devices and servers, and some of those processors are customized for our products. New products that we introduce may utilize custom components obtained from only one source initially until we have evaluated whether there is a need for additional suppliers. Replacing a single source supplier could delay production of some products as replacement suppliers initially may be subject to capacity constraints or other output limitations. For some components, such as customized components and some of the processors that we obtain from Intel, alternative sources may not exist or those alternative sources may be unable to produce the quantities of those components necessary to satisfy our production requirements. In addition, we sometimes purchase components from single source suppliers under short-term agreements that contain favorable pricing and other terms but that may be unilaterally modified or terminated by the supplier with limited notice and with little or no penalty. The performance of such single source suppliers under those agreements (and the renewal or extension of those agreements upon similar terms) may affect the quality, quantity and price of supplies to HP. The loss of a single source supplier, the deterioration of our relationship with a single source supplier, or any unilateral modification to the contractual terms under which we are supplied components by a single source supplier could adversely effect our revenue and gross margins.

*If we fail to comply with our customer contracts or government contracting regulations, our revenue could suffer.*

Our contracts with our customers may include unique and specialized performance requirements. In particular, our contracts with federal, state, provincial and local governmental customers are subject to various procurement regulations, contract provisions and other requirements relating to their formation, administration and performance. Any failure by us to comply with the specific provisions in our customer contracts or any violation of government contracting regulations could result in the imposition of various civil and criminal penalties, which may include termination of contracts, forfeiture of profits, suspension of payments and, in the case of our government contracts, fines and suspension from future government contracting. In addition, we are currently, and in the future may be, subject to *qui tam* litigation brought by private individuals on behalf of the government relating to our government contracts, which could include claims for up to treble damages. Further, any negative publicity related to our customer contracts or any proceedings surrounding them, regardless of its accuracy, may damage our business by affecting our ability to compete for new contracts. If our customer contracts are terminated, if we are suspended from government work, or if our ability to compete for new contracts is adversely affected, we could suffer a material reduction in expected revenue.

*The revenue and profitability of our operations have historically varied, which makes our future financial results less predictable.*

Our revenue, gross margin and profit vary among our products and services, customer groups and geographic markets and therefore will likely be different in future periods than our current results. Overall gross margins and profitability in any given period are dependent partially on the product, customer and geographic mix reflected in that period's net revenue. In particular, IPG and certain of its business units such as printer supplies contribute significantly to our gross margin and profitability. Competition, lawsuits, investigations and other risks affecting IPG, therefore may have a significant impact on our overall gross margin and profitability. Certain segments, and ESS in particular, have a higher fixed cost structure and more variation in gross margins across their business units and product portfolios than others and may therefore experience significant operating profit volatility on a quarterly basis. In addition, newer geographic markets may be relatively less profitable due to investments associated with entering those markets and local pricing pressures, and we may have difficulty establishing and maintaining the operating infrastructure necessary to support the high growth rate associated with some of those markets. Market trends, competitive pressures, commoditization of products, seasonal rebates, increased component or shipping costs, regulatory impacts and other factors may result in reductions in revenue or pressure on gross margins of certain segments in a given period, which may necessitate adjustments to our operations.

*We make estimates and assumptions in connection with the preparation of HP's Consolidated Financial Statements, and any changes to those estimates and assumptions could have a material adverse effect on our results of operations.*

In connection with the preparation of HP's Consolidated Financial Statements, we use certain estimates and assumptions based on historical experience and other factors. Our most critical accounting estimates are described in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report. In addition, as discussed in Note 17 to the Consolidated Financial Statements, we make certain estimates under the provisions of SFAS No. 5 "Accounting for Contingencies," including decisions related to provisions for legal proceedings and other contingencies. While we believe that these estimates and assumptions are reasonable under the circumstances, they are subject to significant uncertainties, some of which are beyond our control. Should any of these estimates and assumptions change or prove to have been incorrect, it could have a material adverse effect on our results of operations.

*Unanticipated changes in HP's tax provisions or exposure to additional income tax liabilities could affect our profitability.*

We are subject to income taxes in the United States and numerous foreign jurisdictions. Our tax liabilities are affected by the amounts we charge for inventory, services, licenses, funding and other items in intercompany transactions. We are subject to ongoing tax audits in various jurisdictions. Tax authorities may disagree with our intercompany charges or other matters and assess additional taxes. We regularly assess the likely outcomes of these audits in order to determine the appropriateness of our tax provision. However, there can be no assurance that we will accurately predict the outcomes of these audits, and the actual outcomes of these audits could have a material impact on our net income or financial condition. In addition, our effective tax rate in the future could be adversely affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes in tax laws and the discovery of new information in the course of our tax return preparation process. In particular, the carrying value of deferred tax assets, which are predominantly in the United States, is dependent on our ability to generate future taxable income in the United States. Any of these changes could affect our profitability.

*Our sales cycle makes planning and inventory management difficult and future financial results less predictable.*

In some of our segments, our quarterly sales often have reflected a pattern in which a disproportionate percentage of each quarter's total sales occur towards the end of such quarter. This uneven sales pattern makes prediction of revenue, earnings, cash flow from operations and working capital for each financial period difficult, increases the risk of unanticipated variations in quarterly results and financial condition and places pressure on our inventory management and logistics systems. If predicted demand is substantially greater than orders, there will be excess inventory. Alternatively, if orders substantially exceed predicted demand, we may not be able to fulfill all of the orders received in the last few weeks of each quarter. Other developments late in a quarter, such as a systems failure, component pricing movements, component shortages or global logistics disruptions, could adversely impact inventory levels and results of operations in a manner that is disproportionate to the number of days in the quarter affected.

We experience some seasonal trends in the sale of our products that also may produce variations in quarterly results and financial condition. For example, sales to governments (particularly sales to the United States government) are often stronger in the third calendar quarter, consumer sales are often stronger in the fourth calendar quarter, and many customers whose fiscal and calendar years are the same spend their remaining capital budget authorizations in the fourth calendar quarter prior to new budget constraints in the first calendar quarter of the following year. European sales are often weaker during the summer months. Demand during the spring and early summer also may be adversely impacted by market anticipation of seasonal trends. Moreover, to the extent that we introduce new products in anticipation of seasonal demand trends, our discounting of existing products may adversely affect our gross margin prior to or shortly after such product launches. Typically, our third fiscal quarter is our weakest and our fourth fiscal quarter is our strongest. Many of the factors that create and affect seasonal trends are beyond our control.

*Any failure by us to execute planned cost reductions successfully could result in total costs and expenses that are greater than expected.*

We have adopted restructuring and other cost reduction plans to bring operational expenses to appropriate levels for each of our businesses, while simultaneously implementing extensive new company-wide expense control programs. These initiatives include:

- A workforce restructuring program and a related U.S. early retirement program announced in July 2005 that we expect to result in the elimination of approximately 14,985 positions by the end of fiscal 2008;

- A multi-year plan announced in the third fiscal quarter of 2006 to reduce IT spending by consolidating HP's 85 data centers worldwide into six larger centers located in three U.S. cities;

- A multi-year program announced in the third fiscal quarter of 2006 to reduce real estate costs by consolidating several hundred HP real estate locations worldwide to fewer core sites;

- Modifications to our defined benefit pension plan, our subsidized retiree medical program and our 401(k) plan announced in February 2007 pursuant to which affected employees will cease accruing pension benefits and will, instead, receive an increased 401(k) match effective January 1, 2008; and

- A U.S. early retirement program announced in February 2007 under which 3,080 employees left the company as of May 31, 2007, all of whom have been or we expect will be replaced.

Our ability to achieve the anticipated cost savings and other benefits from these initiatives within the expected time frame is subject to many estimates and assumptions, including estimates and assumptions regarding the cost of consolidating the data centers and real estate locations, the amount of accelerated depreciation or asset impairment to be incurred when we vacate facilities or cease using equipment before the end of their respective lease term or asset life, the savings associated with the benefit plan changes announced in February 2007, the costs associated with the replacement of employees who retired under the February 2007 early retirement program and the costs and timing of other activities in connection with these initiatives. These estimates and assumptions are subject to significant economic, competitive and other uncertainties, some of which are beyond our control. If these estimates and assumptions are incorrect, if we experience delays, or if other unforeseen events occur, our business and results of operations could be adversely affected.

*In order to be successful, we must attract, retain and motivate key employees, and failure to do so could seriously harm us.*

In order to be successful, we must attract, retain and motivate executives and other key employees, including those in managerial, technical, sales, marketing and IT support positions. Hiring and retaining qualified executives, engineers, skilled solutions providers in the IT support business and qualified sales representatives are critical to our future, and competition for experienced employees in the IT industry can be intense. The failure to hire executives and key employees or the loss of executives and key employees could have a significant impact on our operations.

*Changes to our compensation and benefit programs could adversely affect our ability to attract and retain employees.*

We have historically used stock options and other forms of share-based payment awards as key components of our total rewards employee compensation program in order to align employees' interests with the interests of our stockholders, encourage employee retention and provide competitive compensation and benefit packages. HP began recording charges to earnings for stock-based compensation expense in the first quarter of fiscal 2006 in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment." As a result, we began to incur increased compensation costs associated with our stock-based compensation programs. Moreover, difficulties relating to obtaining stockholder approval of equity compensation plans could make it harder or more expensive for us to grant share-based payment awards to employees in the future. Like other companies, HP has reviewed its equity compensation strategy in light of the current regulatory and competitive environment and has reduced the total number of share-based payment awards granted to employees and the number of employees who receive share-based payment awards. Due to this change in our stock-based compensation strategy, combined with the pension and other benefit plan changes undertaken to reduce costs and our increasing reliance on variable pay, we may find it difficult to attract, retain and motivate employees, and any such difficulty could materially adversely affect our business.

*HP's stock price has historically fluctuated and may continue to fluctuate, which may make future prices of HP's stock difficult to predict.*

HP's stock price, like that of other technology companies, can be volatile. Some of the factors that could affect our stock price are:

- speculation in the press or investment community about, or actual changes in, our business, strategic position, market share, organizational structure, operations, financial condition, financial reporting and results, effectiveness of cost cutting efforts, value or liquidity of our investments, exposure to market volatility, prospects, business combination or investment transactions, or executive team;

- the announcement of new products, services, technological innovations or acquisitions by HP or its competitors; and

- quarterly increases or decreases in revenue, gross margin, earnings or cash flow from operations, changes in estimates by the investment community or guidance provided by HP, and variations between actual and estimated financial results.

General or industry-specific market conditions or stock market performance or domestic or international macroeconomic and geopolitical factors unrelated to HP's performance also may affect the price of HP common stock. For these reasons, investors should not rely on recent trends to predict future stock prices, financial condition, results of operations or cash flows. In addition, following periods of volatility in a company's securities, securities class action litigation against a company is sometimes instituted. If instituted against HP, this type of litigation could result in substantial costs and the diversion of management time and resources.

*System security risks and systems integration issues could disrupt our internal operations or information technology services provided to customers, and any such disruption could harm our revenue, increase our expenses and harm our reputation and stock price.*

Experienced computer programmers and hackers may be able to penetrate our network security and misappropriate our confidential information or that of third parties, create system disruptions or cause shutdowns. In addition, computer programmers and hackers may be able to develop and deploy viruses, worms, and other malicious software programs that attack our products or otherwise exploit any security vulnerabilities of our products. As a result, we could incur significant expenses in addressing problems created by security breaches of our network and any security vulnerabilities of our products. Moreover, we could lose existing or potential customers for information technology outsourcing services or other information technology solutions or incur significant expenses in connection with our customers' system failures or any actual or perceived security vulnerabilities in our products. In addition, sophisticated hardware and operating system software and applications that we produce or procure from third parties may contain defects in design or manufacture, including "bugs" and other problems that could unexpectedly interfere with the operation of the system. The costs to us to eliminate or alleviate security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities could be significant, and the efforts to address these problems could result in interruptions, delays, cessation of service and loss of existing or potential customers that may impede our sales, manufacturing, distribution or other critical functions.

Portions of our IT infrastructure also may experience interruptions, delays or cessations of service or produce errors in connection with systems integration or migration work that takes place from time to time. We may not be successful in implementing new systems and transitioning data, including our current project to consolidate all of our worldwide IT data centers into six centers, which could cause business disruptions and be more expensive, time consuming, disruptive and resource-intensive. Such disruptions could adversely impact our ability to fulfill orders and interrupt other processes. Delayed sales, lower margins or lost customers resulting from these disruptions have adversely affected in the past, and in the future could adversely affect, our financial results, stock price and reputation.

*Any failure by us to manage, complete and integrate acquisitions, divestitures and other significant transactions successfully could harm our financial results, business and prospects and may result in financial results that are different than expected.*

As part of our business strategy, we frequently acquire complementary companies or businesses, divest non-core businesses or assets, enter into strategic alliances and joint ventures and make investments to further our business (collectively, "business combination and investment transactions"). In order to pursue this strategy successfully, we must identify suitable candidates for and successfully complete business combination and investment transactions, some of which may be large and complex, and manage post-closing issues such as the integration of acquired companies or employees. Integration and other risks associated with business combination and investment transactions can be more pronounced for larger and more complicated transactions or if multiple transactions are integrated simultaneously. If we fail to identify and complete successfully business combination and investment transactions that further our strategic objectives, we may be required to expend resources to develop products and technology internally, we may be at a competitive disadvantage or we may be adversely affected by negative market perceptions, any of which may have a material adverse effect on our revenue, gross margin and profitability.

Integration issues are complex, time-consuming and expensive and, without proper planning and implementation, could significantly disrupt our business. The challenges involved in integration include:

- combining product offerings and entering into new markets in which we are not experienced;

- convincing customers and distributors that the transaction will not diminish client service standards or business focus, preventing customers and distributors from deferring purchasing decisions or switching to other suppliers (which could result in our incurring additional obligations in order to address customer uncertainty), minimizing sales force attrition and coordinating sales, marketing and distribution efforts;

- consolidating and rationalizing corporate IT infrastructure, which may include multiple legacy systems from various acquisitions and integrating software code;

minimizing the diversion of management attention from ongoing business concerns;

persuading employees that business cultures are compatible, maintaining employee morale and retaining key employees, engaging with employee works councils representing an acquired company's non-U.S. employees, integrating employees into HP, correctly estimating employee benefit costs and implementing restructuring programs;

coordinating and combining administrative, manufacturing, research and development and other operations, subsidiaries, facilities and relationships with third parties in accordance with local laws and other obligations while maintaining adequate standards, controls and procedures;

achieving savings from supply chain integration; and

managing integration issues shortly after or pending the completion of other independent transactions.

We evaluate and enter into significant business combination and investment transactions on an ongoing basis. We may not fully realize all of the anticipated benefits of any business combination and investment transaction, and the timeframe for achieving benefits of a business combination and investment transaction may depend partially upon the actions of employees, suppliers or other third parties. In addition, the pricing and other terms of our contracts for business combination and investment transactions require us to make estimates and assumptions at the time we enter into these contracts, and, during the course of our due diligence, we may not identify all of the factors necessary to estimate our costs accurately. Any increased or unexpected costs, unanticipated delays or failure to achieve contractual obligations could make these agreements less profitable or unprofitable.

Managing business combination and investment transactions requires varying levels of management resources, which may divert our attention from other business operations. These business combination and investment transactions also have resulted and in the future may result in significant costs and expenses and charges to earnings, including those related to severance pay, early retirement costs, employee benefit costs, asset impairment charges, charges from the elimination of duplicative facilities and contracts, in-process research and development charges, inventory adjustments, assumed litigation and other liabilities, legal, accounting and financial advisory fees, and required payments to executive officers and key employees under retention plans. Moreover, HP has incurred and will incur additional depreciation and amortization expense over the useful lives of certain assets acquired in connection with business combination and investment transactions, and, to the extent that the value of goodwill or intangible assets with indefinite lives acquired in connection with a business combination and investment transaction becomes impaired, we may be required to incur additional material charges relating to the impairment of those assets. In order to complete an acquisition, we may issue common stock, potentially creating dilution for existing stockholders, or borrow, affecting our financial condition and potentially our credit ratings. Any prior or future downgrades in our credit rating associated with an acquisition could adversely affect our ability to borrow and result in more restrictive borrowing terms. In addition, HP's effective tax rate on an ongoing basis is uncertain, and business combination and investment transactions could impact our effective tax rate. We also may experience risks relating to the challenges and costs of closing a business combination and investment transaction and the risk that an announced business combination and investment transaction may not close. As a result, any completed, pending or future transactions may contribute to financial results that differ from the investment community's expectations in a given quarter.

*We cannot predict the outcome of various regulatory inquiries and stockholder derivative action lawsuits arising out of the processes employed in the investigation into leaks of HP confidential information to members of the media, and we may be named in additional regulatory inquiries and stockholder litigation, all of which could result in significant legal and other expenses.*

The Attorney General of the State of California, the Committee on Energy and Commerce of the U.S. House of Representatives, the U.S. Attorney for the Northern District of California, the Division of Enforcement of the SEC and the U.S. Federal Communications Commission all have conducted inquiries or investigations relating to the processes employed in an investigation into leaks of HP confidential information to members of the media that concluded in May 2006. We have entered into an agreement with the California Attorney General to resolve civil claims relating to the leak investigation. Under the terms of the agreement, which includes an injunction, we have paid a total of $14.5 million and agreed to implement and maintain for five years a series of measures designed to ensure that HP's corporate investigations are conducted in accordance with California law and the company's high ethical standards. We also have consented to the entry of an order by the SEC ordering HP to cease and desist from committing or causing violations of the public reporting requirements of the Securities Exchange Act of 1934, as amended. If we fail to implement and maintain the measures required under the agreement with the California Attorney General or if we fail to comply with the SEC cease and desist order, we could be subject to civil or criminal penalties.

Four stockholder derivative lawsuits also have been filed in California (all of which have been consolidated into a single lawsuit) and two in Delaware (both of which have been consolidated into a single lawsuit) purportedly on behalf of HP stockholders seeking to recover damages and to obtain specified injunctive relief stemming from the activities of the leak investigations. We may in the future also be subject to additional litigation or other proceedings arising in relation to these matters. The period of time necessary to resolve the stockholder lawsuits is uncertain, and the expense of defending and concluding such litigation may be significant. In addition, we may be obligated to indemnify (and advance legal expenses to) former or current directors, officers or employees in accordance with the terms of our certificate of incorporation, bylaws, other applicable agreements, and Delaware law.

*Unforeseen environmental costs could impact our future net earnings.*

We are subject to various federal, state, local and foreign laws and regulations concerning environmental protection, such as laws governing the conduct of our facilities and operations with respect to the discharge of pollutants into the air and water, the management and disposal of hazardous substances and wastes and the cleanup of contaminated sites. It is our policy to apply strict standards for environmental clean-up to sites outside the United States, even where we are not required to do so under applicable local laws and regulations. Many of our products are subject to various federal, state and international laws governing chemical substances, including laws regulating the manufacture and distribution of chemical substances and laws restricting the presence of certain substances in electronics products. We could incur substantial costs, including cleanup costs, fines and civil or criminal sanctions, third-party property damage or personal injury claims, or our products could be enjoined from entering certain jurisdictions, if we were to violate or become liable under environmental laws or if our products become non-compliant with environmental laws. The ultimate costs under environmental laws and the timing of these costs are difficult to predict, and liability under some environmental laws relating to contaminated sites can be imposed retroactively and on a joint and several basis. We record a liability for environmental remediation and other environmental costs when we consider the costs to be probable and the amount of the costs can be reasonably estimated. We face increasing complexity in our product design and procurement operations as we adjust to new and future requirements relating to the materials composition of our products, including the restrictions on lead, cadmium and certain other substances that apply to specified electronics products put on the market in the European Union as of July 1, 2006 (Restriction of Hazardous Substances Directive) and similar legislation in other countries including China, Japan and Korea. We also could face significant costs and liabilities in connection with product take-back legislation. The EU has enacted the Waste Electrical and Electronic Equipment Directive (the "WEEE Legislation"), which makes producers of electrical goods, including computers and printers, financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. Similar legislation has been or may be enacted in other jurisdictions, including in the United States, Canada, Mexico, China and Japan. We are continuing to evaluate the cumulative impact of, and are taking steps to comply with, the WEEE Legislation and similar legislation in other jurisdictions as individual countries issue their implementation legislation and guidance.

*Some anti-takeover provisions contained in our certificate of incorporation and bylaws, as well as provisions of Delaware law, could impair a takeover attempt.*

We have provisions in our certificate of incorporation and bylaws, each of which could have the effect of rendering more difficult or discouraging an acquisition of HP deemed undesirable by our Board of Directors. These include provisions:

- authorizing blank check preferred stock, which HP could issue with voting, liquidation, dividend and other rights superior to our common stock;
- limiting the liability of, and providing indemnification to, HP's directors and officers;
- specifying that HP stockholders may take action only at a duly called annual or special meeting of stockholders and otherwise in accordance with our bylaws and limiting the ability of our stockholders to call special meetings;
- requiring advance notice of proposals by HP stockholders for business to be conducted at stockholder meetings and for nominations of candidates for election to our Board of Directors;
- requiring a vote by the holders of two-thirds of HP's outstanding shares to amend certain bylaws relating to HP stockholder meetings, the Board of Directors and indemnification; and
- controlling the procedures for conduct of HP Board and stockholder meetings and election, appointment and removal of HP directors.

These provisions, alone or together, could deter or delay hostile takeovers, proxy contests and changes in control or management of HP. As a Delaware corporation, HP also is subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which prevents some stockholders from engaging in certain business combinations without approval of the holders of substantially all of HP's outstanding common stock.

Any provision of our certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control of HP could limit the opportunity for our stockholders to receive a premium for their shares of HP common stock and also could affect the price that some investors are willing to pay for HP common stock.

**ITEM 1B. Unresolved Staff Comments.**

Not applicable.

**ITEM 2. Properties.**

As of October 31, 2007, we owned or leased a total of approximately 62 million square feet of space worldwide. We believe that our existing properties are in good condition and are suitable for the conduct of our business.

As of October 31, 2007, our sales and support operations occupied approximately 12 million square feet. We own 42% of the space used for sales and support activities and lease the remaining 58%.

Our manufacturing plants, research and development facilities and warehouse and administrative facilities occupied approximately 50 million square feet. We own 57% of our manufacturing, research and development, warehouse and administrative space and lease the remaining 43%. Our plants are equipped with machinery, most of which we own and which, in part, we developed to meet the special requirements of our manufacturing processes. At the end of fiscal 2007, we were productively utilizing the majority of the space in our facilities, while executing our previously announced plans to consolidate our 85 data centers into six larger centers and to reduce our real estate costs and increase our productive utilization by consolidating several hundred real estate locations worldwide to fewer core sites over the next three years.

As indicated above, we have seven business segments: ESS, HPS, HP Software, PSG, IPG, HPFS, and Corporate Investments. Because of the interrelation of these segments, a majority of these segments use substantially all of the properties at least in part, and we retain the flexibility to use each of the properties in whole or in part for each of the segments.

**Principal Executive Offices**

Our principal executive offices, including our global headquarters, are located at 3000 Hanover Street, Palo Alto, California, United States of America.

**Headquarters of Geographic Operations**

The locations of our headquarters of geographic operations at October 31, 2007 were as follows:

| ***Americas*** | ***Europe, Middle East, Africa*** | ***Asia Pacific, including Japan*** |
|---|---|---|
| Houston, Texas | Geneva, Switzerland | Singapore |

**Product Development and Manufacturing**

The locations of our major product development and manufacturing facilities and HP Labs at October 31, 2007 were as follows:

| ***Americas*** | ***Europe, Middle East, Africa*** | ***Hewlett-Packard Laboratories*** |
|---|---|---|
| Cupertino, Fremont, Palo Alto, Roseville, San Diego and Woodland, California | Herrenberg, Germany | Palo Alto, California |
| | Dublin, Ireland | Beijing, China |
| Fort Collins and Colorado Springs, Colorado | Rehovot and Netanya, Israel | Bangalore, India |
| Boise, Idaho | Amersfoort, The Netherlands | Haifa, Israel |
| Indianapolis, Indiana | Barcelona, Spain | Tokyo, Japan |
| Andover and Marlboro, Massachusetts | Erskine, United Kingdom | Bristol, United Kingdom |
| Nashua, New Hampshire | ***Asia Pacific, including Japan*** | |
| Corvallis, Oregon | Shanghai, China | |
| Memphis, Tennessee | Bangalore, India | |
| Houston, Texas | Pantangar, India | |
| Sandston, Virginia | Akishima, Japan | |
| Vancouver, Washington | Singapore | |
| Aguadilla, Puerto Rico | | |

**ITEM 3. Legal Proceedings.**

Information with respect to this item may be found in Note 17 to the Consolidated Financial Statements in Item 8, which is incorporated herein by reference.

**ITEM 4. Submission of Matters to a Vote of Security Holders.**

Not applicable.

# PART II

## ITEM 5. Market for the Registrant's Common Equity and Related Stockholder Matters.

Information regarding the market prices of HP common stock and the markets for that stock may be found in the "Quarterly Summary" in Item 8 and on the cover page of this Annual Report on Form 10-K, respectively, which are incorporated herein by reference. We have paid cash dividends each fiscal year since 1965. The current rate is $0.08 per share per quarter. As of November 30, 2007, there were approximately 142,000 stockholders of record. Additional information concerning dividends may be found in "Selected Financial Data" in Item 6 and in Item 8, which are incorporated herein by reference.

### Recent Sales of Unregistered Securities

There were no unregistered sales of equity securities during fiscal 2007.

### Issuer Purchases of Equity Securities

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet Be Purchased under the Plans or Programs |
|---|---|---|---|---|
| Month #1 (August 2007) | 24,543,000 | $ 47.40 | 24,543,000 | $ 3,591,773,284 |
| Month #2 (September 2007) | 12,945,679 | $ 49.49 | 12,945,679 | $ 2,951,106,386 |
| Month #3 (October 2007) | 4,600,000 | $ 51.39 | 4,600,000 | $ 2,714,725,466 |
| Total | 42,088,679 | $ 48.48 | 42,088,679 | |

HP repurchased shares in the fourth quarter of fiscal 2007 under an ongoing program to manage the dilution created by shares issued under employee stock plans as well as to repurchase shares opportunistically. This program, which does not have a specific expiration date, authorizes repurchases in the open market or in private transactions. All shares repurchased in the fourth quarter of fiscal 2007 were purchased in open market transactions.

As of October 31, 2007, HP had remaining authorization of approximately $2.7 billion for future share repurchases under the $8.0 billion repurchase authorization approved by HP's Board of Directors on March 15, 2007.

On November 19, 2007, HP's Board of Directors authorized an additional $8.0 billion for future repurchases of HP's outstanding shares of common stock.

**Stock Performance Graph and Cumulative Total Return**

The graph below shows the cumulative total stockholder return assuming the investment of $100 on the date specified (and the reinvestment of dividends thereafter) in each of HP common stock, the S&P 500 Index, and the S&P Information Technology Index.[1] The comparisons in the graph below are based upon historical data and are not indicative of, or intended to forecast, future performance of our common stock.

| | 10/02 | 10/03 | 10/04 | 10/05 | 10/06 | 10/07 |
|---|---|---|---|---|---|---|
| Hewlett-Packard Company | 100.00 | 143.60 | 121.96 | 185.85 | 259.34 | 348.52 |
| S&P 500 | 100.00 | 120.80 | 132.18 | 143.71 | 167.19 | 191.54 |
| S&P Information Technology | 100.00 | 141.21 | 140.00 | 147.59 | 162.26 | 205.90 |

(1) The stock performance graph does not include HP's peer group because peer group information is represented and included in the S&P Information Technology Index.

**ITEM 6. Selected Financial Data.**

The information set forth below is not necessarily indicative of results of future operations and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the Consolidated Financial Statements and notes thereto included in Item 8, "Financial Statements and Supplementary Data," of this Form 10-K, which are incorporated herein by reference, in order to understand further the factors that may affect the comparability of the financial data presented below.

**HEWLETT-PACKARD COMPANY AND SUBSIDIARIES**
**Selected Financial Data**

| | For the fiscal years ended October 31, | | | | |
|---|---|---|---|---|---|
| | **2007** | **2006** | **2005** | **2004** | **2003** |
| | In millions, except per share amounts | | | | |
| Net revenue | $ 104,286 | $ 91,658 | $ 86,696 | $ 79,905 | $ 73,061 |
| Earnings from operations[1] | $ 8,719 | $ 6,560 | $ 3,473 | $ 4,227 | $ 2,896 |
| Net earnings | $ 7,264 | $ 6,198 | $ 2,398 | $ 3,497 | $ 2,539 |
| Net earnings per share | | | | | |
| Basic | $ 2.76 | $ 2.23 | $ 0.83 | $ 1.16 | $ 0.83 |
| Diluted | $ 2.68 | $ 2.18 | $ 0.82 | $ 1.15 | $ 0.83 |
| Cash dividends declared per share | $ 0.32 | $ 0.32 | $ 0.32 | $ 0.32 | $ 0.32 |
| At year-end: | | | | | |
| Total assets | $ 88,699 | $ 81,981 | $ 77,317 | $ 76,138 | $ 74,716 |
| Long-term debt | $ 4,997 | $ 2,490 | $ 3,392 | $ 4,623 | $ 6,494 |

(1) Earnings from operations include the following items:

| | **2007** | **2006** | **2005** | **2004** | **2003** |
|---|---|---|---|---|---|
| | In millions | | | | |
| Amortization of purchased intangible assets | $ 783 | $ 604 | $ 622 | $ 603 | $ 563 |
| Stock-based compensation expense | 629 | 536 | 104 | 48 | 45 |
| Restructuring charges | 387 | 158 | 1,684 | 114 | 800 |
| In-process research and development charges | 190 | 52 | 2 | 37 | 1 |
| Pension curtailments and pension settlements, net | (517) | | (199) | | |
| Acquisition-related charges | | | | 54 | 280 |
| Total charges before taxes | $ 1,472 | $ 1,350 | $ 2,213 | $ 856 | $ 1,689 |
| Total charges, net of taxes | $ 1,137 | $ 970 | $ 1,583 | $ 604 | $ 1,157 |

**ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

**HEWLETT-PACKARD COMPANY AND SUBSIDIARIES**

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion should be read in conjunction with the Consolidated Financial Statements and the related notes that appear elsewhere in this document.*

## OVERVIEW

We are a leading global provider of products, technologies, software, solutions and services to individual consumers, small- and medium-sized businesses ("SMBs"), and large enterprises, including in the public and education sectors. Our offerings span:

- personal computing and other access devices;
- imaging and printing-related products and services;
- enterprise information technology infrastructure, including enterprise storage and server technology, and software that optimizes business technology investments; and
- multi-vendor customer services, including technology support and maintenance, consulting and integration and outsourcing services.

We have seven business segments: Enterprise Storage and Servers ("ESS"), HP Services ("HPS"), HP Software, the Personal Systems Group ("PSG"), the Imaging and Printing Group ("IPG"), HP Financial Services ("HPFS"), and Corporate Investments. ESS, HPS and HP Software are structured beneath a broader Technology Solutions Group ("TSG"). While TSG is not an operating segment, we sometimes provide financial data aggregating the segments within TSG in order to provide a supplementary view of our business.

The operating framework in which we manage our businesses and guide our strategies is based on the disciplined management of three business levers: targeted growth, operational efficiency and capital strategy. Although we have made progress towards our goals in recent periods, there are still many areas in which we believe that we can improve. To implement this operating framework, we are focused on the following initiatives:

- We are engaged in a process of examining every function and every business in the company in order to optimize efficiency and reduce cost;
- We are in the process of consolidating 85 data centers worldwide into six state-of-the-art centers in three U.S. cities and consolidating several hundred real estate locations worldwide to fewer core sites in order to reduce our IT spending and real estate costs;
- We are reinvesting a portion of the cost savings from these initiatives by expanding our sales force and aligning our resources in order to build our market share in emerging markets while expanding our coverage to drive growth in mature markets;
- We are developing training programs for our sales forces designed to enhance our ability to provide solutions to our customers and build customer loyalty;

We are building and expanding our services organization to support our technology businesses and provide comprehensive solutions to our customers;

We are developing a global delivery structure to take advantage of regions where advanced technical expertise is available at lower costs;

We are expanding our ethics and compliance programs and enhancing our corporate governance to ensure that all of our actions are consistent with HP's values; and

We are repurchasing shares of our common stock under an ongoing program to manage the dilution created by shares issued under employee stock plans as well as to repurchase shares opportunistically.

We continue to grow our business organically and through strategic acquisitions. During fiscal 2007, we acquired ten companies, among which the two largest were Mercury Interactive Corporation ("Mercury") and Opsware Inc., and we expect to continue to make strategic acquisitions periodically in the future.

In February 2007, we announced our decision to modify our U.S. defined benefit pension plan for the remaining number of U.S. employees still accruing benefits under the program. Effective January 1, 2008, these employees will cease accruing pension benefits and will, instead, receive an increased 401(k) match to 6 percent from 4 percent of eligible earnings. The final pension benefit amount will be calculated based on pay and service through December 31, 2007. In addition, future eligibility for the Pre-2003 HP Retiree Medical Program was limited to those employees who were within five years of satisfying the program's eligibility criteria on June 30, 2007. These actions reduced our U.S. defined benefit and post-retirement plan obligations, and, as a result, we recorded a one-time curtailment gain of $542 million in fiscal 2007. In conjunction with this announcement, we provided eligible affected employees with the opportunity to participate in a 2007 U.S. Enhanced Early Retirement program (the "2007 EER") and recorded a restructuring charge of $354 million during fiscal 2007. A total of 3,080 employees participated in the 2007 EER, including 595 persons who had been included in previous restructuring programs or who voluntarily left the company since November 30, 2006. All employees who participated in the 2007 EER left the company by May 31, 2007. For more information, see Notes 8 and 15 to the Consolidated Financial Statements in Item 8, which are incorporated herein by reference.

In terms of how our execution has translated into financial performance, the following provides an overview of our key fiscal 2007 financial metrics:

| | | TSG | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **HP Consolidated** | **ESS** | **HPS** | **HP Software** | **Total** | **PSG** | **IPG** | **HPFS** |
| | **In millions, except per share amounts** | | | | | | | |
| Net revenue | $ 104,286 | $ 18,769 | $ 16,646 | $ 2,325 | $ 37,740 | $ 36,409 | $ 28,465 | $ 2,336 |
| Year-over-year net revenue % increase | 13.8% | 8.4% | 6.6% | 78.7% | 10.3% | 24.8% | 6.3% | 12.4% |
| Earnings from operations | $ 8,719 | $ 1,980 | $ 1,829 | $ 347 | $ 4,156 | $ 1,939 | $ 4,315 | $ 155 |
| Earnings from operations as a % of net revenue | 8.4% | 10.5% | 11.0% | 14.9% | 11.0% | 5.3% | 15.2% | 6.6% |
| Net earnings | $ 7,264 | | | | | | | |
| Net earnings per share | | | | | | | | |
| Basic | $ 2.76 | | | | | | | |
| Diluted | $ 2.68 | | | | | | | |

Cash and cash equivalents at October 31, 2007 totaled $11.3 billion, a decrease of $5.1 billion from the October 31, 2006 balance of $16.4 billion. The decrease for fiscal 2007 was related primarily to $10.9 billion paid to repurchase our common stock, $6.8 billion of net cash paid for business acquisitions and $2.5 billion net investments in property, plant and equipment, all of which were partially offset by $9.6 billion in cash provided from operations, $3.1 billion in proceeds from the issuance of our common stock under employee stock plans and a $2.6 billion net increase in our debt and commercial paper.

We intend the discussion of our financial condition and results of operations that follows to provide information that will assist in understanding our Consolidated Financial Statements, the changes in certain key items in those financial statements from year to year, and the primary factors that accounted for those changes, as well as how certain accounting principles, policies and estimates affect our Consolidated Financial Statements.

The discussion of results of operations at the consolidated level is followed by a more detailed discussion of results of operations by segment.

For a further discussion of factors that could impact operating results, see the section entitled "Risk Factors" in Item 1A, which is incorporated herein by reference.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

*General*

The Consolidated Financial Statements of HP are prepared in accordance with U.S. generally accepted accounting principles, which require management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, net revenue and expenses, and the disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Senior management has discussed the development, selection and disclosure of these estimates with the Audit Committee of HP's Board of Directors. Management believes that the accounting estimates employed and the resulting balances are reasonable; however, actual results may differ from these estimates under different assumptions or conditions.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the estimate that are reasonably likely to occur could materially impact the financial statements. Management believes the following critical accounting policies reflect the significant estimates and assumptions used in the preparation of the Consolidated Financial Statements.

*Revenue Recognition*

We enter into contracts to sell our products and services, and, while the majority of our sales agreements contain standard terms and conditions, there are agreements that contain multiple elements or non-standard terms and conditions. As a result, significant contract interpretation is sometimes required to determine the appropriate accounting, including whether the deliverables specified in a multiple element arrangement should be treated as separate units of accounting for revenue recognition purposes, and, if so, how the price should be allocated among the elements and when to recognize revenue for each element. We recognize revenue for delivered elements only when the delivered elements have standalone value, fair values of undelivered elements are known, uncertainties regarding customer acceptance are resolved and there are no customer-negotiated refund or return rights affecting the revenue recognized for delivered elements. Changes in the allocation of the sales price between elements might impact the timing of revenue recognition but would not change the total revenue recognized on the contract.

We recognize revenue as work progresses on certain fixed-price contracts, such as consulting arrangements. Using a proportional performance method, we estimate the total expected labor costs in order to determine the amount of revenue earned to date. We follow this basis because reasonably dependable estimates of the labor costs applicable to various stages of a contract can be made. Total contract profit is subject to revisions throughout the life of the contract. We record changes in revenue as a result of revisions to cost estimates to income in the period in which the facts that give rise to the revision become known.

We record estimated reductions to revenue for customer and distributor programs and incentive offerings, including price protection, promotions, other volume-based incentives and expected returns. Future market conditions and product transitions may require us to take actions to increase customer incentive offerings, possibly resulting in an incremental reduction of revenue at the time the incentive is offered. Additionally, certain incentive programs require us to estimate, based on historical experience, the number of customers who will actually redeem the incentive.

*Restructuring*

We have engaged, and may continue to engage, in restructuring actions, which require management to utilize significant estimates related to expenses for severance and other employee separation costs, realizable values of assets made redundant or obsolete, lease cancellation and other exit costs. If the actual amounts differ from our estimates, the amount of the restructuring charges could be materially impacted. For a full description of our restructuring actions, refer to our discussions of restructuring in the Results of Operations section and Note 8 to the Consolidated Financial Statements in Item 8, which are incorporated herein by reference.

*Stock-Based Compensation Expense*

Effective November 1, 2005, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), using the modified prospective transition method, and therefore have not restated prior periods' results. Under this method, we recognize stock-based compensation expense for all share-based payment awards granted after November 1, 2005 and granted prior to but not yet vested as of November 1, 2005, in accordance with SFAS 123R. Under the fair value recognition provisions of SFAS 123R, we recognize stock-based compensation expense net of an estimated forfeiture rate and recognize compensation cost for only those shares expected to vest on a straight-line basis over the requisite service period of the award. Prior to SFAS 123R adoption, we accounted for share-based payment awards under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and, accordingly, generally recognized compensation expense only when we granted options with a discounted exercise price.

Determining the appropriate fair value model and calculating the fair value of share-based payment awards require subjective assumptions, including the expected life of the share-based payment awards and stock price volatility. Management determined that implied volatility calculated based on actively traded options on HP common stock is a better indicator of expected volatility and future stock price trends than historical volatility. Therefore, expected volatility in fiscal years 2007, 2006 and 2005 was based on a market-based implied volatility. The assumptions used in calculating the fair value of share-based payment awards represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and recognize expense only for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period. See Note 2 to the Consolidated Financial Statements in Item 8 for a further discussion on stock-based compensation.

*Taxes on Earnings*

We calculate our current and deferred tax provisions based on estimates and assumptions that could differ from the actual results reflected in our income tax returns filed during the subsequent year. We record adjustments based on filed returns when we have identified and finalized them, which is generally in the third and fourth quarters of the subsequent year for U.S. federal and state provisions, respectively.

We recognize deferred tax assets and liabilities for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts using enacted tax rates in effect for the year in which we expect the differences to reverse. We record a valuation allowance to reduce the deferred tax assets to the amount that we are more likely than not to realize. We have considered future market growth, forecasted earnings, future taxable income, the mix of earnings in the jurisdictions in which we operate and prudent and feasible tax planning strategies in determining the need for a valuation allowance. In the event we were to determine that we would not be able to realize all or part of our net deferred tax assets in the future, we would increase the valuation allowance and make a corresponding charge to earnings in the period in which we make such determination. Likewise, if we later determine that we are more likely than not to realize the net deferred tax assets, we would reverse the applicable portion of the previously provided valuation allowance. In order for us to realize our deferred tax assets we must be able to generate sufficient taxable income in the tax jurisdictions in which the deferred tax assets are located.

Our effective tax rate includes the impact of certain undistributed foreign earnings for which we have not provided U.S. taxes because we plan to reinvest such earnings indefinitely outside the United States. We plan foreign earnings remittance amounts based on projected cash flow needs as well as the working capital and long-term investment requirements of our foreign subsidiaries and our domestic operations. Based on these assumptions, we estimate the amount we will distribute to the United States and provide the U.S. federal taxes due on these amounts. Further, as a result of certain employment actions and capital investments HP has undertaken, income from manufacturing activities in certain countries is subject to reduced tax rates, and in some cases is wholly exempt from taxes, for fiscal years through 2019. Material changes in our estimates of cash, working capital and long-term investment requirements in the various jurisdictions in which we do business could impact our effective tax rate.

We are subject to income taxes in the United States and over sixty foreign countries, and we are subject to routine corporate income tax audits in many of these jurisdictions. We believe that our tax return positions are fully supported, but tax authorities are likely to challenge certain positions, which may not be fully sustained. However, our income tax expense includes amounts intended to satisfy income tax assessments that result from these challenges. Determining the income tax expense for these potential assessments and recording the related assets and liabilities requires significant management judgments and estimates. We evaluate our income tax contingencies in accordance with SFAS No. 5, "Accounting for Contingencies." We believe that our reserve for income tax liabilities, including related interest, is adequate in relation to the potential for additional tax assessments. The amounts ultimately paid upon resolution of audits could be materially different from the amounts previously included in our income tax expense and therefore could have a material impact on our tax provision, net income and cash flows. Our reserve for income tax liabilities is attributable primarily to uncertainties concerning the tax treatment of our international operations, including the allocation of income among different jurisdictions, and related interest. We review our reserves quarterly, and we may adjust such reserves because of proposed assessments by tax authorities, changes in facts and circumstances, issuance of new regulations or new case law, previously unavailable information obtained during the course of an examination, negotiations between tax authorities of different countries concerning our transfer prices, execution of Advanced Pricing Agreements, resolution with respect to individual audit issues, the resolution of entire audits, or the expiration of statutes of limitations. Material adjustments are most likely to occur in the fiscal years in which major ongoing audits, such as audits by the Internal Revenue Service ("IRS"), are closed. In addition, our tax contingency reserve includes certain amounts for potential tax assessments for pre-acquisition tax years of acquired companies which, if released, will impact the carrying value of goodwill attributable to the acquired company.

*Allowance for Doubtful Accounts*

We determine our allowance for doubtful accounts using a combination of factors to ensure that we have not overstated our trade and financing receivables balances due to uncollectibility. We maintain an allowance for doubtful accounts for all customers based on a variety of factors, including the length of time receivables are past due, trends in overall weighted-average risk rating of the total portfolio, macroeconomic conditions, significant one-time events, historical experience and the use of third-party credit risk models that generate quantitative measures of default probabilities based on market factors, and the financial condition of customers. Also, we record specific provisions for individual accounts when we become aware of a customer's inability to meet its financial obligations to us, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position. If circumstances related to customers change, we would further adjust our estimates of the recoverability of receivables either upward or downward. The annual provision for doubtful accounts has averaged approximately 0.01% of net revenue over the last three fiscal years. Using our third-party credit risk model at October 31, 2007, a 50-basis-point deterioration in the weighted-average default probabilities of our significant customers would have resulted in an approximately $84 million increase to our trade allowance at the end of fiscal year 2007.

*Inventory*

We state our inventory at the lower of cost or market. We make adjustments to reduce the cost of inventory to its net realizable value, if required, at the product group level for estimated excess, obsolescence or impaired balances. Factors influencing these adjustments include changes in demand, rapid technological changes, product life cycle and development plans, component cost trends, product pricing, physical deterioration and quality issues. Revisions to these adjustments would be required if these factors differ from our estimates.

*Valuation of Goodwill and Indefinite-Lived Purchased Intangible Assets*

We review goodwill and purchased intangible assets with indefinite lives for impairment annually and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." The provisions of SFAS No. 142 require that we perform a two-step impairment test on goodwill. In the first step, we compare the fair value of each reporting unit to its carrying value. Our reporting units are consistent with the reportable segments identified in Note 18 to the Consolidated Financial Statements in Item 8. We determine the fair value of our reporting units based on a weighting of income and market approaches. Under the income approach, we calculate the fair value of a reporting unit based on the present value of estimated future cash flows. Under the market approach, we estimate the fair value based on market multiples of revenue or earnings for comparable companies. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and we are not required to perform further testing. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then we must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then we record an impairment loss equal to the difference. SFAS No. 142 also requires that the fair value of the purchased intangible assets with indefinite lives be estimated and compared to the carrying value. We estimate the fair value of these intangible assets using an income approach. We recognize an impairment loss when the estimated fair value of the intangible asset is less than the carrying value.

Determining the fair value of a reporting unit or an indefinite-lived purchased intangible asset is judgmental in nature and involves the use of significant estimates and assumptions. These estimates and assumptions include revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, assumed royalty rates, future economic and market conditions and determination of appropriate market comparables. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. Actual future results may differ from those estimates. In addition, we make certain judgments and assumptions in allocating shared assets and liabilities to determine the carrying values for each of our reporting units.

Our annual goodwill impairment analysis, which we performed during the fourth quarter of fiscal 2007, did not result in an impairment charge. The excess of fair value over carrying value for each of HP's reporting units as of August 1, 2007, the annual testing date, ranged from approximately $520 million to approximately $46 billion. In order to evaluate the sensitivity of the fair value calculations on the goodwill impairment test, we applied a hypothetical 10% decrease to the fair values of each reporting unit. This hypothetical 10% decrease would result in excess fair value over carrying value ranging from approximately $360 million to approximately $41 billion for each of HP's reporting units.

*Warranty Provision*

We provide for the estimated cost of product warranties at the time we recognize revenue. We evaluate our warranty obligations on a product group basis. Our standard product warranty terms generally include post-sales support and repairs or replacement of a product at no additional charge for a specified period of time. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers, we base our estimated warranty obligation upon warranty terms, ongoing product failure rates, repair costs, product call rates, average cost per call, and current period product shipments. If actual product failure rates, repair rates, service delivery costs or post-sales support costs differ from our estimates, we would be required to make revisions to the estimated warranty liability. Warranty terms generally range from

90 days to three years parts and labor, depending upon the product. Over the last three fiscal years, the annual warranty provision has averaged approximately 3.4% of annual net product revenue, while actual annual warranty costs have averaged approximately 3.2% of annual net product revenue.

*Retirement Benefits*

Our pension and other post-retirement benefit costs and obligations are dependent on various assumptions. Our major assumptions relate primarily to discount rates, salary growth, long-term return on plan assets and medical cost trend rates. We base the discount rate assumption on current investment yields of high quality fixed income investments during the retirement benefits maturity period. The salary growth assumptions reflect our long-term actual experience and future and near-term outlook. Long-term return on plan assets is determined based on historical portfolio results and management's expectation of the future economic environment, as well as target asset allocations. In the beginning of fiscal 2008, we implemented a liability-driven investment strategy for the U.S. defined benefit pension plan, which will be frozen by December 31, 2007 and is currently overfunded. As part of the strategy, we have transitioned our equity allocation to predominantly fixed income assets. The expected return on the plan assets, used in calculating the net benefit cost, has been reduced from 8.3% to 6.3% for fiscal 2008 to reflect the changes in our asset allocation policy. Our medical cost trend assumptions are developed based on historical cost data, the near-term outlook and an assessment of likely long-term trends. Actual results that differ from our assumptions are accumulated and are amortized generally over the estimated future working life of the plan participants.

Our major assumptions vary by plan and the weighted-average rates used are set forth in Note 15 to the Consolidated Financial Statements in Item 8, which is incorporated herein by reference. Each assumption has different sensitivity characteristics, and, in general, changes, if any, have moved in the same direction over the last several years. For fiscal 2007, changes in the weighted-average rates would have had the following impact on our net periodic benefit cost:

- A decrease of 25 basis points in the long-term rate of return would have increased our net benefit cost by approximately $33 million;

- A decrease of 25 basis points in the discount rate would have increased our net benefit cost by approximately $51 million; and

- An increase of 25 basis points in the future compensation rate would have increased our net benefit cost by approximately $21 million.

**RECENT ACCOUNTING PRONOUNCEMENTS**

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing the recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006 and is required to be adopted by us in the first quarter of fiscal 2008. The cumulative effects of applying FIN 48 will be recorded as an adjustment to retained earnings as of the beginning of the period of adoption. Additionally, in May 2007, the FASB published FASB Staff Position No. FIN 48-1, "Definition of Settlement in FASB Interpretation No. 48" ("FSP FIN 48-1").

FSP FIN 48-1 is an amendment to FIN 48. It clarifies how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FSP FIN 48-1 is effective upon the initial adoption of FIN 48, and therefore will be adopted by us in the first quarter of fiscal 2008. While we are still evaluating the impact of adoption of FIN 48 and FSP FIN 48-1 on our consolidated financial statements, we estimate that the adoption of FIN 48 and FSP FIN 48-1 will result in a net increase to retained earnings in the range of $500 million to $900 million. This estimate is subject to revision as management completes its analysis.

In September 2006, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 provides guidance for using fair value to measure assets and liabilities. It also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value, and does not expand the use of fair value in any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and is required to be adopted by us in the first quarter of fiscal 2009. We are currently evaluating the effect that the adoption of SFAS 157 will have on our consolidated results of operations and financial condition and are not yet in a position to determine such effects.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans An Amendment of FASB No. 87, 88, 106 and 132(R)" ("SFAS 158"). SFAS 158 requires that the funded status of defined benefit postretirement plans be recognized on the company's balance sheet and changes in the funded status be reflected in comprehensive income, effective for fiscal years ending after December 15, 2006, which we adopted during fiscal 2007. See Note 15 to the Consolidated Financial Statements in Item 8 for the effect of applying this provision on the consolidated financial statements. SFAS 158 also requires companies to measure the funded status of the plan as of the date of their fiscal year end, effective for fiscal years ending after December 15, 2008. We expect to adopt the measurement provisions of SFAS 158 effective October 31, 2009.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 expands the use of fair value accounting but does not affect existing standards that require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. Other eligible items include firm commitments for financial instruments that otherwise would not be recognized at inception and non-cash warranty obligations where a warrantor is permitted to pay a third party to provide the warranty goods or services. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred, such as debt issuance costs. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by us in the first quarter of fiscal 2009. We currently are determining whether fair value accounting is appropriate for any of our eligible items and cannot estimate the impact, if any, that SFAS 159 will have on our consolidated results of operations and financial condition.

In June 2007, the FASB also ratified EITF 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities" ("EITF 07-3"). EITF 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized and recognized as an expense as the goods are delivered or the related services are performed. EITF 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007 and will be adopted by us in the first quarter of fiscal 2009. We do not expect the adoption of EITF 07-3 to have a material effect on our consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008, and will be adopted by us in the first quarter of fiscal 2010. We are currently evaluating the potential impact, if any, of the adoption of SFAS 141R on our consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51" ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008, and will be adopted by us in the first quarter of fiscal 2010. We are currently evaluating the potential impact, if any, of the adoption of SFAS 160 on our consolidated results of operations and financial condition.

In addition to the SFAS 158 adoption mentioned above, we adopted the following accounting standards in fiscal 2007, none of which had a material effect on our consolidated results of operations during such period or financial condition at the end of such period:

- SFAS No. 154, "Accounting for Changes and Error Corrections";
- Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements";
- EITF 05-5, "Accounting for Early Retirement or Postemployment Programs with Specific Features (Such as Terms Specified in Altersteilzeit Early Retirement Arrangements)"; and
- EITF 06-9, "Reporting a Change in (or the Elimination of) a Previously Existing Difference between the Fiscal Year End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee."

**RESULTS OF OPERATIONS**

Results of operations in dollars and as a percentage of net revenue were as follows for the following fiscal years ended October 31:

| | 2007 | | 2006[2] | | 2005[2] | |
|---|---|---|---|---|---|---|
| | In millions | | | | | |
| Net revenue | $ 104,286 | 100.0% | $ 91,658 | 100.0% | $ 86,696 | 100.0% |
| Cost of sales[1] | 78,887 | 75.6% | 69,427 | 75.7% | 66,440 | 76.6% |
| Gross profit | 25,399 | 24.4% | 22,231 | 24.3% | 20,256 | 23.4% |
| Research and development | 3,611 | 3.5% | 3,591 | 3.9% | 3,490 | 4.0% |
| Selling, general and administrative | 12,226 | 11.7% | 11,266 | 12.3% | 11,184 | 13.0% |
| Amortization of purchased intangible assets | 783 | 0.7% | 604 | 0.7% | 622 | 0.7% |
| In-process research and development charges | 190 | 0.2% | 52 | | 2 | |
| Restructuring charges | 387 | 0.4% | 158 | 0.2% | 1,684 | 1.9% |
| Pension curtailments and pension settlements, net | (517) | (0.5)% | | | (199) | (0.2)% |
| Earnings from operations | 8,719 | 8.4% | 6,560 | 7.2% | 3,473 | 4.0% |
| Interest and other, net | 444 | 0.4% | 606 | 0.6% | 83 | 0.1% |
| Gains (losses) on investments | 14 | | 25 | | (13) | |
| Earnings before taxes | 9,177 | 8.8% | 7,191 | 7.8% | 3,543 | 4.1% |
| Provision for taxes | 1,913 | 1.8% | 993 | 1.0% | 1,145 | 1.3% |
| Net earnings | $ 7,264 | 7.0% | $ 6,198 | 6.8% | $ 2,398 | 2.8% |

(1) Cost of products, cost of services and financing interest.

(2) Certain reclassifications have been made to prior year amounts in order to conform to the current year presentation.

*Net Revenue*

The components of weighted-average net revenue growth as compared to prior-year periods were as follows for the following fiscal years ended October 31:

| | 2007 | 2006 |
|---|---|---|
| | Percentage points | |
| Personal Systems Group | 7.9 | 2.8 |
| Imaging and Printing Group | 1.8 | 1.9 |
| Enterprise Storage and Servers | 1.6 | 0.7 |
| HP Software | 1.1 | 0.3 |
| HP Services | 1.1 | 0.1 |
| HP Financial Services | 0.3 | (0.1) |
| Corporate Investments/Other | | |
| Total HP | 13.8 | 5.7 |

In fiscal 2007, HP net revenue increased approximately 14% from the prior year period (10% on a constant currency basis). The favorable currency impact for fiscal 2007 was due primarily to the movement of the dollar against the euro. U.S. net revenue was $34.8 billion for fiscal 2007, an increase of 8% from the prior year, while international net revenue increased 17% to $69.5 billion.

PSG had double-digit net revenue growth across all regions as a result of overall unit volume increases of 28%. The unit volume increases resulted from strong growth in notebooks with significant improvements in emerging markets. The impact of these increases was partially offset by declines in average selling prices ("ASPs") in commercial and consumer clients of 5% and 1%, respectively. IPG net revenue growth in fiscal 2007 was due mainly to increased unit volumes of printer supplies resulting from the continued expansion of printer hardware placements and the strong performance of supplies for color-related products. ESS net revenue growth during fiscal 2007 was the result primarily of strong blade revenue and unit growth in our industry standard servers business, increased option attach rates in our ProLiant server line, continued strong performance in mid-range EVA products, growth in commercial storage area networks and revenue increases from our Integrity servers. The ESS growth was partially moderated by the revenue declines in our tape business, high-end arrays and our PA-RISC and Alpha server product lines during fiscal 2007. The net revenue growth in HP Software during fiscal 2007 was due primarily to growth in our OpenView business as a result of the Mercury acquisition and increases in revenue from license and support contracts. HPS net revenue during fiscal 2007 increased due primarily to favorable currency impacts, revenue increases in outsourcing services driven by existing accounts growth and new business, and revenue increases in consulting and integration associated with acquisitions made in fiscal 2007. The HPFS net revenue increase during fiscal 2007 was due primarily to operating lease growth and higher end-of-lease activity.

In fiscal 2006, HP net revenue increased approximately 6% from the prior year period (7% on a constant currency basis). The unfavorable currency impact for fiscal 2006 was due primarily to the movement of the dollar against the euro and the yen. U.S. net revenue was $32.2 billion for fiscal 2006, an increase of 6% from the prior year, while international net revenue increased 6% to $59.4 billion.

PSG net revenue increased across all regions as a result of a 15% volume increase. The volume increase resulted from strong growth in consumer and commercial markets and significant improvement in emerging markets, which was partially offset by 6% and 7% declines in ASPs in consumer and commercial clients, respectively. IPG net revenue growth in fiscal 2006 was due mainly to increased shipment volumes of printer supplies resulting from the continued expansion of printer hardware placements and the strong performance of color-related products. ESS net revenue growth was the result primarily of strong unit growth in our industry standard servers business, blade revenue growth, increased option attach rates in our ProLiant server line, continued strong performance in mid-range EVA products within our Storage business and revenue increases from our Integrity servers. The ESS growth was moderated by revenue declines in our tape business and PA-RISC and Alpha Server product lines. The net revenue growth in HP Software for fiscal 2006 was due primarily to growth in our OpenView business as a result of the Peregrine acquisition and an increase in support and service contracts. HPS net revenue increased in fiscal 2006 due primarily to revenue increases in management services driven by new business and existing account growth, which were offset by declines in the technology services business resulting from competitive pricing pressures and changes in the mix of platforms being serviced. The HPFS net revenue decline in fiscal 2006 was due primarily to lower used equipment sales.

*Stock-Based Compensation Expense*

See Note 2 to the Consolidated Financial Statements in Item 8, which is incorporated herein by reference.

*Gross Margin*

The weighted-average components of the change in gross margin as compared to prior-year periods were as follows for the following fiscal years ended October 31:

| | **2007** | **2006** |
|---|---|---|
| | **Percentage points** | |
| HP Software | 0.6 | 0.2 |
| HP Services | 0.1 | 0.2 |
| Enterprise Storage and Servers | (0.1) | 0.4 |
| HP Financial Services | (0.1) | (0.1) |
| Personal Systems Group | (0.2) | 0.1 |
| Imaging and Printing Group | (0.2) | 0.2 |
| Corporate Investments/Other | | (0.1) |
| Total HP | 0.1 | 0.9 |

Total company gross margin increased slightly in fiscal 2007 from fiscal 2006. The improvement in HP Software gross margin in fiscal 2007 was due primarily to a favorable change in revenue mix driven by the inclusion of revenue from Mercury licenses and support, which typically have a higher gross margin than the other offerings within the segment. HPS gross margin increased during fiscal 2007 from fiscal 2006 due primarily to continued focus on cost structure improvements from delivery efficiencies and cost controls. This gross margin increase was partially offset by the impact from the continued competitive pricing environment. During fiscal 2007, ESS contributed unfavorably to our total company's weighted-average change in gross margin while the ESS gross margin remained stable. This stability was due primarily to improved cost management, which was offset by an ongoing mix shift to lower-margin Integrity products within business critical systems and a continued mix shift towards industry standard servers. HPFS gross margin decline during fiscal 2007 was caused primarily by increased bad debt expenses and lower bad debt recoveries, as well as lower margins on leases and used equipment sales. During fiscal 2007, PSG contributed unfavorably to our total company's weighted-average change in gross margin as a result of higher growth than the other segments. However, PSG gross margin increased primarily as a result of component cost declines and improvements in supply chain costs per unit, which were partially offset by ASP declines. During fiscal 2007, IPG gross margin decreased due primarily to unfavorable hardware margins, increased costs associated with new product introductions and a change in product mix.

Total company gross margin increased in fiscal 2006 as compared to fiscal 2005. The improvement in ESS gross margin in fiscal 2006 was due primarily to a favorable unit mix, improved discount management, and lower component costs. HPS gross margin increase was driven mainly by the continued focus on cost structure improvement from delivery efficiencies and cost controls, the impact of which was partially offset by the continued competitive environment in the solutions and services business and higher fiscal 2006 bonus accruals. For IPG, gross margin increased in fiscal 2006 due primarily to improved supplies margins and a favorable portfolio mix shift from hardware to supplies, which were partially offset by unfavorable consumer hardware margins. The improvement in HP Software gross margin in fiscal 2006 was due primarily to an increase in revenue and more effective management of the support and services costs for OpenView and OpenCall. The gross margin improvement in PSG resulted primarily from reduced warranty expense and supply chain costs as a percentage of revenue and component cost declines. HPFS gross margin was impacted unfavorably in fiscal 2006 due primarily to competitor pricing pressures, a higher mix of lower margin operating lease assets and lower recoveries for bad debts, which were partially offset by lower credit losses in fiscal 2006.

*Operating Expenses*

Research and Development

Total research and development ("R&D") expense increased in fiscal 2007 due primarily to additional R&D expense as a result of the Mercury acquisition in the first quarter of fiscal 2007. As a percentage of net revenue, each of our major segments experienced a year-over-year decrease in R&D expense in fiscal 2007.

Total R&D expense increased in fiscal 2006 due primarily to higher bonus accruals and stock-based compensation expense, the impact of which was partially offset by expense controls and cost savings from restructuring actions. As a percentage of net revenue, each of our major segments experienced a year-over-year decrease in R&D expense in fiscal 2006.

Selling, General and Administrative

Total SG&A expense increased during fiscal 2007 due primarily to additional expense as a result of the acquisition of Mercury in the first quarter of fiscal 2007, unfavorable currency impacts related to the movement of the dollar against the euro and additional investments in our sales forces. As a percentage of net revenue, the ESS, HPS, PSG and IPG segments experienced a year-over-year decrease in SG&A expense during fiscal 2007, while HP Software experienced a year-over-year increase in SG&A expense.

Total SG&A expense increased slightly during fiscal 2006 as higher bonus accruals and stock-based compensation expenses as well as increased marketing spending were offset in part by savings from expense controls and restructuring actions and favorable currency impacts due to movement of the dollar against the euro and the yen. As a percentage of net revenue, each of our segments experienced a year-over-year decrease or no change in fiscal 2006.

### Amortization of Purchased Intangible Assets

The increase in amortization expense in fiscal 2007 as compared to fiscal 2006 was due primarily to amortization expense related to the acquisition of Mercury in the first quarter of fiscal 2007. This increase was partially offset by a decrease in amortization expense related to certain intangible assets associated with prior acquisitions, including the Compaq Computer Corporation ("Compaq") acquisition, that had reached the end of their amortization period.

The decrease in amortization expense in fiscal 2006 as compared to fiscal 2005 was due primarily to a decrease in amortization expense related to certain intangible assets associated with prior acquisitions including the Compaq acquisition that had reached the end of their amortization period, which decrease was partially offset by an increase in amortization expense related primarily to the acquisitions of Scitex Vision Ltd. ("Scitex"), Peregrine Systems, Inc. ("Peregrine"), and OuterBay Technologies, Inc. ("OuterBay") in fiscal year 2006.

For more information on our amortization of purchased intangibles assets, see Note 7 to the Consolidated Financial Statements in Item 8, which is incorporated herein by reference.

### In-Process Research and Development Charges

We record in-process research and development ("IPR&D") charges in connection with acquisitions accounted for as business combinations, as more fully described in Note 6 to the Consolidated Financial Statements in Item 8. In fiscal 2007, 2006 and 2005 we recorded IPR&D charges of $190 million, $52 million, and $2 million, respectively, related to acquisitions during those years. The increase in IPR&D in fiscal 2007 was due primarily to our acquisition of Mercury in the first quarter of fiscal 2007.

### Restructuring Charges

Restructuring charges for fiscal 2007 were $387 million, which included $354 million of expenses related to severance and other benefit costs associated with those employees who elected to participate in the 2007 EER and a net charge of $33 million relating to adjustments to our fiscal 2005, 2003, 2002 and 2001 restructuring programs.

Restructuring charges in fiscal year 2006 were $158 million. This included a net charge of $233 million related to true-ups of severance and other related restructuring charges for all restructuring plans, a $6 million termination benefits expense and a $3 million settlement and curtailment loss from our non-U.S. pension plans related to the fiscal 2005 restructuring plan, which was approved by our Board of Directors in the fourth quarter of fiscal 2005. These charges were partially offset by a $46 million settlement gain from the U.S. pension plans, a $24 million curtailment gain from the U.S. retiree medical program and a $14 million adjustment to reduce our non-cash stock-based compensation expense, all related to our fiscal 2005 restructuring plan approved in the fourth quarter of fiscal 2005.

Restructuring charges in fiscal 2005 were $1.7 billion, which included a $1.6 billion charge for the fiscal 2005 restructuring plan approved in the fourth quarter of fiscal 2005. The fiscal 2005 restructuring plan was designed to simplify our structure, reduce costs and place greater focus on our customers. We initially estimated that 15,300 positions would be eliminated in the fiscal 2005 restructuring plan.

Subsequent to the initial estimate, we reduced the number of total positions to be eliminated to 14,985. We had substantially completed eliminating these positions as of October 31, 2007. The remaining charge for fiscal 2005 of $109 million was related to severance and related costs associated with the termination of approximately 1,450 employees in connection with a restructuring plan approved by our management in the third quarter of fiscal 2005. All employees under this restructuring plan were terminated as of October 31, 2005. We paid all of the costs associated with the fiscal 2005 third quarter restructuring plan as of January 31, 2007.

For more information on our restructuring charges, see Note 8 to the Consolidated Financial Statements in Item 8, which is incorporated herein by reference.

*Workforce Rebalancing*

As part of our ongoing business operations, we incur workforce rebalancing charges for severance and related costs within certain business segments. Workforce rebalancing activities are considered part of normal operations as we continue to optimize our cost structure and are included in our business segment results. We expect to incur additional workforce rebalancing costs in the future.

Pension Curtailments and Pension Settlements, Net

In fiscal 2007, we recognized a net gain on pension curtailments and settlements of $517 million, relating primarily to a $542 million curtailment gain associated with a modification to our U.S. defined benefit pension plan and post-retirement benefit plan. This curtailment gain was offset partially by net settlement losses related to our other pension plan design changes.

In conjunction with management's plan to restructure certain of our operations, we modified our U.S. retirement programs to align them more closely to industry practice. Effective January 1, 2006, we ceased pension accruals and eliminated eligibility for the subsidized retiree medical program for employees who did not meet defined criteria based on age and years of service. As a result, we recognized a curtailment gain of $199 million in fiscal 2005 stemming from the elimination of future benefit accruals for the affected employee group.

For more information on our plan design changes, see Note 15 to the Consolidated Financial Statements in Item 8, which is incorporated herein by reference.

*Interest and Other, Net*

Interest and other, net decreased by $162 million in fiscal 2007 from fiscal 2006. The decrease was due primarily to higher interest expense resulting from higher average debt balances.

Interest and other, net increased by $523 million in fiscal 2006 from fiscal 2005. The increase in fiscal 2006 resulted primarily from higher net interest income over the prior year related to higher short-term interest rates in fiscal 2006, net gains from sales of certain real estate properties, and lower interest expense due to our lower average debt balances. The increase in fiscal 2006 also was attributable to a net $106 million of dispute settlement charge and its related interest charge recorded in fiscal 2005. In fiscal 2005, we reached a legal settlement of $141 million in our patent infringement case with Intergraph Hardware Technologies Company ("Intergraph") and recorded a charge of $116 million related to a cross-license agreement with Intergraph for products shipped in prior years. Partially offsetting this amount was a $10 million recovery from an individual related to a prior period settlement with the Government of Canada.

*Gains (Losses) on Investments*

Net gains on investment in fiscal 2007 and fiscal 2006 resulted primarily from gains on the sale of equity investments, which were offset in part by impairment charges on our investment portfolio. Net losses in fiscal 2005 resulted primarily from impairment charges on equity investments in our publicly-traded and privately-held investment portfolios. Partially offsetting these losses were gains attributable to the sale of investments.

*Provision for Taxes*

Our effective tax rates were 20.8%, 13.8%, and 32.3% in fiscal 2007, 2006 and 2005, respectively.

The increase in the overall tax rate in fiscal 2007 from fiscal 2006 was related in part to favorable income tax adjustments of $599 million recorded in fiscal 2006, which included net favorable tax adjustments of $565 million to income tax accruals as a result of the settlement of IRS examinations of our U.S. income tax returns for fiscal years 1993 to 1998. The reductions to the net income tax accruals for these years related primarily to the resolution of issues with respect to Puerto Rico manufacturing tax incentives and export tax incentives, and other issues involving our non-U.S. operations.

In addition, the decrease in the overall tax rate in 2006 from fiscal 2005 was attributable in part to $697 million of income tax expense related to items unique to fiscal 2005. The tax expense was the result primarily of $792 million associated with the repatriation of $14.5 billion under the American Jobs Creation Act of 2004 ("Jobs Act") and $76 million related to additional distributions received from foreign subsidiaries. These tax expenses were offset in part by tax benefits of $177 million resulting from agreements with the IRS and other governmental authorities. The Jobs Act, enacted on October 22, 2004, provided for a temporary 85% dividend received deduction on certain foreign earnings repatriated during a one-year period. The deduction resulted in an approximate 5.25% federal tax rate on the repatriated earnings.

For a full reconciliation of our effective tax rate to the U.S. federal statutory rate of 35% and further explanation of our provision for taxes, see Note 13 to the Consolidated Financial Statements in Item 8, which is incorporated herein by reference.

**Segment Information**

A description of the products and services, as well as financial data, for each segment can be found in Note 18 to the Consolidated Financial Statements in Item 8, which is incorporated herein by reference. We have realigned segment financial data for the fiscal years ended October 31, 2006 and 2005 to reflect changes in HP's organizational structure that occurred at the beginning of the first quarter of fiscal 2007. We describe these changes more fully in Note 18 to the Consolidated Financial Statements in Item 8. We have presented the business segments in this Annual Report on Form 10-K based on our management organizational structure as of October 31, 2007 and the distinct nature of various businesses. Future changes to this organizational structure may result in changes to the reportable segments disclosed. The discussions below include the results of each of our segments.

***Technology Solutions Group***

ESS, HPS and HP Software are structured beneath a broader Technology Solutions Group ("TSG"). We describe the results of the business segments of TSG in more detail below.

***Enterprise Storage and Servers***

| | For the fiscal years ended October 31 | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | | In millions | |
| Net revenue | $ 18,769 | $ 17,308 | $ 16,717 |
| Earnings from operations | $ 1,980 | $ 1,446 | $ 800 |
| Earnings from operations as a % of net revenue | 10.5% | 8.4% | 4.8% |

The components of weighted-average net revenue growth as compared to prior-year periods by business unit were as follows for the following fiscal years ended October 31:

| | 2007 | 2006 |
|---|---|---|
| | Percentage points | |
| Industry standard servers | 8.0 | 3.5 |
| Storage | 0.9 | 0.9 |
| Business critical systems | (0.5) | (0.9) |
| Total ESS | 8.4 | 3.5 |

On a constant currency basis, ESS net revenue increased 5% in fiscal 2007 from fiscal 2006. The favorable currency impact in fiscal 2007 was due primarily to the movement of the dollar against the euro. Industry standard servers revenue grew 14% in fiscal 2007 compared to fiscal 2006 as a result of strong growth in blade revenue and units, as well as increased option attach rates in the ProLiant server line. Storage net revenue increased 4% in fiscal 2007 compared to fiscal 2006, with the increase driven primarily by mid-range EVA products and commercial products within the storage area networks offerings, as well as improved revenue growth in storage software. This increase was partially moderated by the revenue declines in our tape business and high-end arrays. Business critical systems net revenue decreased 3% in fiscal 2007 compared to fiscal 2006. The decrease was due primarily to revenue declines in the PA-RISC product line and the planned phase out of our Alpha server product line. The declines were partially offset by strong net revenue growth in our Integrity servers, which represented 64% of the business critical systems revenue mix in fiscal 2007, up from 37% in fiscal 2006. We expect revenue mix from Integrity servers to continue to grow as customers migrate from PA-RISC and Alpha products.

In fiscal 2007, ESS earnings from operations as a percentage of net revenue increased by 2.1 percentage points compared to fiscal 2006, due primarily to a decrease in operating expenses as a percentage of net revenue. Gross margin remained stable in fiscal 2007 compared to fiscal 2006 due primarily to improved cost management. The improved cost management was offset by an ongoing mix shift to lower-margin integrity products within business critical systems and a continued mix shift towards industry standard servers. The decrease in operating expense as a percentage of net revenue in fiscal 2007 was due primarily to cost structure improvements.

On a constant currency basis, ESS net revenue increased 5% in fiscal 2006 from fiscal 2005. The unfavorable currency impact for fiscal 2006 was due primarily to the movement of the dollar against the euro and the yen. The net revenue growth in industry standard servers of 6% in fiscal 2006 compared to fiscal 2005 was driven by strong unit growth and the growth in blade revenue as well as increased option attach rates in the ProLiant server line. Storage net revenue increased 4% in fiscal 2006 compared to fiscal 2005 due to continued strong performance in mid-range EVA products within the storage area networks offerings while the tape business decline moderated the overall storage growth. Business critical systems net revenue decreased 4% in fiscal 2006 compared to fiscal 2005. This decrease was due primarily to revenue declines in the PA-RISC product line and to the planned phase out of our Alpha server product line. The declines were partially offset by net revenue growth in our Integrity servers which posted strong net revenue growth, reaching 37% of the business critical systems revenue mix in fiscal 2006 up from 20% in the prior fiscal year. Revenue mix from Integrity servers continued to grow as customers migrated from PA-RISC and Alpha products. Integrity server revenue in fiscal 2006 also included revenue from Montecito-based Integrity servers that were first shipped in the fourth quarter of fiscal 2006. NonStop server net revenue decreased 2% in fiscal 2006 from the prior year due primarily to the revenue decrease on the discontinued product line, which was partially offset by NonStop Integrity product revenue growth.

In fiscal 2006, ESS earnings from operations as a percentage of net revenue increased by 3.6 percentage points compared to fiscal 2005, due primarily to an increase in gross margin combined with a decrease in operating expenses as a percentage of net revenue. The improvement in gross margin was due primarily to a favorable unit mix, improved discount management, and lower component costs. The increase was partially offset by a continued mix shift towards industry standard servers within the segment and the ongoing mix shift to lower-margin Integrity products within business critical systems. The decrease in operating expense as a percentage of net revenue in fiscal 2006 was due primarily to efficient expense management.

***HP Services***

| | For the fiscal years ended October 31 | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | | In millions | |
| Net revenue | $ 16,646 | $ 15,617 | $ 15,536 |
| Earnings from operations | $ 1,829 | $ 1,507 | $ 1,151 |
| Earnings from operations as a % of net revenue | 11.0% | 9.6% | 7.4% |

The components of weighted-average net revenue growth as compared to prior-year periods by business unit were as follows for the following fiscal years ended October 31:

| | 2007 | 2006 |
|---|---|---|
| | Percentage points | |
| Technology services | 2.1 | (1.6) |
| Outsourcing services[(1)] | 2.8 | 1.8 |
| Consulting and integration | 1.7 | 0.3 |
| Total HPS | 6.6 | 0.5 |

(1) Reflects the name change from managed services to outsourcing services effective in fiscal 2007.

On a constant currency basis, HPS net revenue increased 3% in fiscal 2007 from fiscal 2006. In fiscal 2007, the favorable currency impact was due primarily to the movement of the dollar against the euro. Net revenue in technology services increased 4% in fiscal 2007 from the prior year due primarily to favorable currency impacts, growth in the IT solution support services and extended warranty revenue, the impact of which was partially offset by competitive pricing pressures and revenue erosion from installed base contracts. Net revenue in outsourcing services increased 10% in fiscal 2007 from the prior year. The increase was driven mainly by favorable currency impacts, existing account growth and new business, which were partially offset by installed base revenue erosion and pricing pressures. Net revenue in consulting and integration increased 9% in fiscal 2007 from the prior year due mainly to acquisitions made in fiscal 2007 and favorable currency impacts.

HPS earnings from operations as a percentage of net revenue in fiscal 2007 increased by 1.4 percentage points. The operating margin increase was the result of an increase in gross margin and a decrease in operating expenses as a percentage of net revenue. The gross margin increase in fiscal 2007 was due primarily to the continued focus on cost structure improvements generated by delivery efficiencies and cost controls, the impact of which was partially offset by the impact from the continued competitive pricing environment. In fiscal 2007, continued efficiency improvements in our operating expense structure contributed to the decline in operating expenses as a percentage of net revenue compared to the prior year. Technology services operating margin in fiscal 2007 continued to benefit from improved delivery efficiencies and cost controls, the impact of which was offset in part by the impact of the ongoing portfolio mix shift from higher margin proprietary support to lower margin areas such as IT solution services. Outsourcing services operating margin increased in fiscal 2007 due primarily to improved delivery efficiencies and reduced operating expenses partially offset by contractual pricing pressure. Consulting and integration operating margin decreased in fiscal 2007 due mainly to increased customer project losses and acquisition related costs, the impact of which was partially offset by more efficient utilization of our consultants and operating expense improvement.

On a constant currency basis, HPS net revenue increased 2% in fiscal 2006 from fiscal 2005. In fiscal 2006, the unfavorable currency impact was due primarily to the movement of the dollar against the euro and the yen. Net revenue in technology services decreased 3% in fiscal 2006 from the prior year due primarily to declines related to competitive pricing pressures and changes in the mix of platforms being serviced. In fiscal 2006, the 7% growth in outsourcing services net revenue from the prior year was driven mainly by new business and existing account growth, with continued focus on making more strategic portfolio decisions to improve profitability. Net revenue in consulting and integration increased 2% in fiscal 2006 from the prior year due primarily to improved performance in Asia Pacific and Europe, Middle East and Africa.

HPS earnings from operations as a percentage of net revenue in fiscal 2006 increased by 2.2 percentage points. The operating margin increase was the result of a combination of an increase in gross margin and a decrease in operating expenses as a percentage of net revenue. The gross margin increase in HPS was due primarily to the continued focus on cost structure improvement from delivery efficiencies and cost controls, the impact of which was partially offset by the continued competitive environment in solutions and services business and higher fiscal 2006 bonus accruals. In fiscal 2006, improved efficiencies in our operating expense structure contributed to the decline in operating expenses as a percentage of net revenue compared to fiscal year 2005 despite the impact of higher bonus accruals in fiscal 2006. Technology services operating margin in fiscal 2006 continued to benefit from improved delivery efficiencies and cost controls as well as portfolio decisions made to improve profitability, all of which benefit was offset in part by the impact of the ongoing portfolio mix shift from higher margin proprietary support to lower margin areas such as solution services. Outsourcing services operating margin increased in fiscal 2006 due to delivery efficiencies, reduced operating expenses and more strategic portfolio decisions made to improve profitability. Consulting and integration operating margin improved in fiscal 2006 due to more efficient utilization of our consultants and reduced operating expenses.

***HP Software***

| | For the fiscal years ended October 31 | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | | In millions | |
| Net revenue | $ 2,325 | $ 1,301 | $ 1,061 |
| Earnings (loss) from operations | $ 347 | $ 85 | $ (49) |
| Earnings (loss) from operations as a % of net revenue | 14.9% | 6.5% | (4.6)% |

On a constant currency basis, HP Software revenue increased 74% in fiscal 2007 as compared to fiscal 2006. The favorable currency impact was due primarily to the movement of the dollar against the euro. Excluding the results of Mercury, HP Software's revenue grew 5% in fiscal 2007. Net revenue associated with the acquisition of Mercury was included in the results of OpenView, which increased 121% in fiscal 2007 and 15% in the same respective period without Mercury. OpenView net revenue growth also was the result of increases in revenue from license and support contracts. Net revenue for OpenCall, our telecommunications solutions product line, decreased 16% in fiscal 2007. The decrease in OpenCall net revenue was due primarily to a platform shift that resulted in a transfer of the hardware revenue to ESS.

The operating margin improvement of 8.4 percentage points in fiscal 2007 as compared to fiscal 2006 was the result primarily of an increase in gross margin and to a lesser degree a decrease in operating expense as a percentage of net revenue. In fiscal 2007, the improvement in gross margin was a result of a favorable change in revenue mix driven by the inclusion of revenue from Mercury licenses and support, which typically have a higher gross margin than the other offerings in the segment, and to a lesser degree by more effective management of the support costs for OpenView and OpenCall. Operating expense as a percentage of net revenue in fiscal 2007 decreased due primarily to cost controls and synergy savings from the Mercury acquisition.

In fiscal 2006, Software net revenue increased 23% (8% excluding the impact of acquisitions and 24% on a constant currency basis) from fiscal 2005. The unfavorable currency impact was due primarily to the movement of the dollar against the euro and the yen for fiscal 2006. Peregrine, which HP acquired in December 2005, represented 14.7 percentage points of HP Software's net revenue growth for fiscal 2006. Net revenue associated with the Peregrine acquisition is included in the results of OpenView, our management solutions software product line, which represented 20 percentage points of growth on a weighted-average net revenue basis for fiscal 2006. OpenCall contributed the remaining 3 percentage points of the weighted-average net revenue increase for fiscal 2006. OpenView net revenue growth was the result of acquisitions and increases in support and services contracts. OpenCall net revenue growth was the result of increased product sales and licenses as well as larger contracts.

The operating margin improvement of 11.1 percentage points for fiscal 2006 from fiscal 2005 was the result primarily of a decrease in operating expense as a percentage of net revenue and an increase in gross margin. The decrease in operating expense as a percentage of net revenue was attributable to growth in field selling costs, research and development and marketing expenses attributable to cost management efforts that was slower than revenue growth. These cost reductions were partially offset by high integration costs associated with the acquisition of Peregrine as well as higher bonus accruals. The improvement in gross margin was driven by an increase in revenue, more effective management of the support and services costs for OpenView and OpenCall and from improved margins of our OpenCall product line resulting from a favorable product mix shift towards higher margin products.

***Personal Systems Group***

| | For the fiscal years ended October 31 | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | | In millions | |
| Net revenue | $ 36,409 | $ 29,166 | $ 26,741 |
| Earnings from operations | $ 1,939 | $ 1,152 | $ 657 |
| Earnings from operations as a % of net revenue | 5.3% | 3.9% | 2.5% |

The components of weighted-average net revenue growth as compared to prior-year periods by business unit were as follows for the following fiscal years ended October 31:

| | 2007 | 2006 |
|---|---|---|
| | Percentage points | |
| Notebook PCs | 19.3 | 8.4 |
| Desktop PCs | 4.2 | 0.8 |
| Workstations | 1.2 | 0.6 |
| Handhelds | (0.4) | (0.8) |
| Other | 0.5 | 0.1 |
| Total PSG | 24.8 | 9.1 |

On a constant currency basis, PSG's net revenue increased 21% in fiscal 2007 from fiscal 2006. The favorable currency impact was due primarily to the movement of the dollar against the euro. Unit volumes increased by 28% in fiscal 2007, driving double-digit net revenue growth across all regions. The unit volume increase was the result of strong growth in notebooks, with significant improvements in emerging markets. In fiscal 2007, net revenue for notebook PCs increased 47% while net revenue for desktop PCs increased 8% from the prior-year period. In fiscal 2007, net revenue for consumer clients increased 39%, while net revenue for commercial clients increased 16% from the prior-year period. The net revenue increase in Other PSG in fiscal 2007 was related primarily to improvements in extended warranty sales. The revenue increase was partially offset by decreases in handhelds revenue due to declines in the Personal Digital Assistant ("PDA") product market, which were partially offset by our new converged device and travel companion products. In fiscal 2007, the positive revenue impact from the PSG unit volume increase compared to fiscal 2006 was also moderated by a 5% decline in commercial client ASPs and a 1% decline in consumer client ASPs. ASPs declined from the prior year was a result of price erosion related to component cost reductions, the impact of which was partially offset by increased notebook mix and monitor attach rates.

PSG earnings from operations as a percentage of net revenue increased by 1.4 percentage points in fiscal 2007 from fiscal 2006 as a result of decreases in operating expenses as a percentage of net revenue coupled with an increase in gross margin. The increased gross margin was primarily a result of component cost declines and improvements in supply chain costs per unit, the impact of which was partially offset by ASP declines. The operating expense decline as a percentage of net revenue in fiscal 2007 was the result primarily of the increased net revenue and continued efforts to improve our cost structure through efficiency measures.

On a constant currency basis, PSG's net revenue increased 10% in fiscal 2006. The unfavorable currency impact was due primarily to the movement of the dollar against the euro and the yen. In fiscal 2006, net revenue increased across all regions and each business unit with the exception of handhelds, due primarily to an overall volume increase of 15%. The volume increase in fiscal 2006 was the result of strong growth in the consumer and commercial markets, with significant improvement in emerging markets. Net revenue for notebook PCs increased 23% while net revenue for desktop PCs increased slightly in fiscal 2006 from the prior year. Net revenue for consumer clients and commercial clients increased 19% and 4%, respectively, from the prior year. The revenue increases in consumer and commercial clients were partially offset by a decrease in handhelds revenue due to a decline in the PDA product market coupled with our product transition to converged devices. The PSG volume increase in fiscal 2006 was moderated by a decline of 6% in consumer client ASPs and 7% in commercial client ASPs. The ASP declines were due to pricing decisions resulting from lower component costs as well as competitive pricing pressures, the impact of which was partially offset by a strong monitor attach rate in commercial desktops PCs.

PSG earnings from operations as a percentage of net revenue increased by 1.4 percentage points in fiscal 2006 from fiscal 2005 as a result of gross margin improvement and a decrease in operating expenses as a percentage of revenue. The gross margin improvement was due primarily to reduced supply chain costs and warranty expense as a percentage of net revenue, combined with component cost declines. The operating expense decline as a percentage of net revenue was the result primarily of the increased net revenue and continued efforts on improving cost structure through efficiency measures. Operating expenses decreased slightly in fiscal 2006 due primarily to savings from our expense controls, which savings were partially offset by higher bonus accruals in fiscal 2006.

***Imaging and Printing Group***

| | For the fiscal years ended October 31 | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | In millions | | |
| Net revenue | $ 28,465 | $ 26,786 | $ 25,155 |
| Earnings from operations | $ 4,315 | $ 3,978 | $ 3,413 |
| Earnings from operations as a % of net revenue | 15.2% | 14.9% | 13.6% |

The components of weighted-average net revenue growth as compared to prior-year periods by business unit were as follows for the following fiscal years ended October 31:

| | 2007 | 2006 |
|---|---|---|
| | Percentage points | |
| Supplies | 5.2 | 5.4 |
| Commercial hardware | 1.0 | 1.4 |
| Consumer hardware | 0.1 | (0.3) |
| Total IPG | 6.3 | 6.5 |

On a constant currency basis, net revenue increased 4% in fiscal 2007 from fiscal 2006. The favorable currency impact was due primarily to the movement of the dollar against the euro in fiscal 2007. The growth in printer supplies net revenue in fiscal 2007 from fiscal 2006 reflected higher unit volumes of supplies as a result of the continued expansion of printer hardware placements and the strong performance of supplies for color-related products. The growth in commercial hardware net revenue in fiscal 2007 was attributable mainly to unit volume growth in multifunction printers and revenue from our digital press and large format printing products. The slight increase in consumer hardware net revenue in fiscal 2007 was attributable to increased unit volumes, improved average revenue per unit performance and a mix shift from single function products to All-in-Ones, the impact of which was partially offset by the continued shift in demand to lower priced products and strategic pricing decisions.

IPG earnings from operations as a percentage of net revenue increased by 0.3 percentage points in fiscal 2007 from fiscal 2006, driven by a decrease in operating expenses as a percentage of net revenue that was partially offset by a decrease in gross margin. Gross margin decreased due primarily to unfavorable hardware margins, increased costs associated with new product introductions and a change in product mix. Operating expenses as a percentage of net revenue decreased due primarily to higher prior-year research and development expenses associated with product introduction costs, coupled with higher revenue and more effective spending controls.

On a constant currency basis, net revenue increased 7% in fiscal 2006 from fiscal 2005. The unfavorable currency impact was due primarily to the movement of the dollar against the euro and the yen in fiscal 2006. In fiscal 2006, the growth in printer supplies net revenue reflected higher unit volumes as a result of the continued expansion of printer hardware placements and the strong performance of color-related products. The growth in commercial hardware net revenue in fiscal 2006 was attributable mainly to unit volume growth in color laser printers and multifunction printers and, to a lesser extent, revenue from our large format printing products with the acquisition of Scitex in November 2005. Commercial and consumer hardware revenue was unfavorably impacted by the continued shift in demand to lower-priced products and strategic pricing decisions, which caused average revenue per unit to decline.

IPG earnings from operations as a percentage of net revenue increased 1.3 percentage points in fiscal 2006 from fiscal 2005, which was the result primarily of an increase in gross margin and a decrease in operating expense as a percentage of net revenue. The gross margin increase was due primarily to improved margins for supplies due to product mix and a favorable portfolio mix shift from hardware to supplies, the impact of which was partially offset by unfavorable consumer hardware margins. Operating expense as a percentage of net revenue for fiscal 2006 declined, due mainly to realized savings from our cost structure initiatives coupled with increased revenue and partially offset by higher bonus accruals.

***HP Financial Services***

| | For the fiscal years ended October 31 | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | In millions | | |
| Net revenue | $ 2,336 | $ 2,078 | $ 2,102 |
| Earnings from operations | $ 155 | $ 147 | $ 213 |
| Earnings from operations as a % of net revenue | 6.6% | 7.1% | 10.1% |

HPFS net revenue increased by 12% in fiscal 2007 from fiscal 2006. The net revenue increase was due primarily to operating lease growth and higher end-of-lease activity. The financing lease growth and increased used equipment sales, to a lesser extent, also contributed to the revenue growth.

HPFS earnings from operations as a percentage of net revenue decreased by 0.5 percentage point in fiscal 2007 from fiscal 2006 due primarily to a decrease in gross margin, which was partially offset by a decrease in operating expense as a percentage of net revenue. The gross margin decrease was driven primarily by increased bad debt expenses and lower bad debt recoveries, as well as lower margins on leases and used equipment sales. The decline in operating expenses as a percentage of net revenue was due to continued cost controls.

HPFS net revenue decreased by 1% in fiscal 2006 from fiscal 2005. The net revenue decrease was due primarily to lower used equipment sales and other end-of-lease revenue, which were largely offset by a higher mix of leases classified as operating leases.

In fiscal 2006, the 3.0 percentage point decrease in earnings from operations as a percentage of net revenue consisted of a decrease in gross margin, which was partially offset by a decrease in operating expense as a percentage of net revenue. The gross margin decline was due primarily to competitor pricing pressures, a higher mix of lower margin operating lease assets and lower recoveries for bad debts, the impact of which was partially offset by lower credit losses. The decrease in operating expenses as a percentage of net revenue was the result of cost savings achieved through continued cost controls.

*Financing Originations*

| | For the fiscal years ended October 31 | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| | | **In millions** | |
| Total financing originations | $ 4,441 | $ 3,994 | $ 4,136 |

New financing originations, which represent the amounts of financing provided to customers for equipment and related software and services, and include intercompany activity, increased 11% in fiscal 2007 from fiscal 2006. The increase reflects higher financing associated with HP product sales resulting from improved integration and engagement with HP's sales efforts and a favorable currency impact. Financing originations decreased 3% in fiscal 2006 from fiscal 2005 with the decrease reflecting lower financing associated with HP product sales.

*Portfolio Assets and Ratios*

HPFS maintains a strategy to generate a competitive return on equity by effectively leveraging its portfolio against the risks associated with interest rates and credit. The HPFS business model is asset-intensive and uses certain internal metrics to measure its performance against other financial services companies, including a segment balance sheet that is derived from our internal management reporting system. The accounting policies used to derive these amounts are substantially the same as those used by the consolidated company. However, certain intercompany loans and accounts that are reflected in the segment balances are eliminated in our Consolidated Financial Statements.

The portfolio assets and ratios derived from the segment balance sheet for HPFS were as follows for the following fiscal years ended October 31:

| | 2007 | 2006 |
|---|---|---|
| | In millions | |
| Portfolio assets[1] | $ 8,415 | $ 7,345 |
| Allowance for doubtful accounts | 84 | 80 |
| Operating lease equipment reserve | 49 | 42 |
| Total reserves | 133 | 122 |
| Net portfolio assets | $ 8,282 | $ 7,223 |
| Reserve coverage | 1.6% | 1.7% |
| Debt to equity ratio[2] | 6.0x | 6.0x |

(1) Portfolio assets include gross financing receivables of approximately $5.4 billion at October 31, 2007 and $4.9 billion at October 31, 2006 and net equipment under operating leases of $1.8 billion at October 31, 2007 and $1.5 billion at October 31, 2006, as disclosed in Note 10 to the Consolidated Financial Statements in Item 8, which is incorporated herein by reference. Portfolio assets also include capitalized profit on intercompany equipment transactions of approximately $500 million at October 31, 2007 and $400 million at October 31, 2006, and intercompany leases of approximately $700 million at October 31, 2007 and $500 million at October 31, 2006, both of which are eliminated in consolidation.

(2) HPFS debt consists of intercompany equity that is treated as debt for segment reporting purposes, intercompany debt and debt issued directly by HPFS.

Portfolio assets at October 31, 2007 increased 15% from October 31, 2006. The increase resulted from a favorable currency impact and a high level of financing originations in fiscal 2007. The overall percentage of portfolio assets reserved decreased due primarily to the write-off of assets covered by specific reserves. HPFS funds its operations mainly through a combination of intercompany debt and equity.

***Corporate Investments***

| | For the fiscal years ended October 31 | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | | In millions | |
| Net revenue | $ 762 | $ 566 | $ 523 |
| Loss from operations | $ (57) | $ (151) | $ (174) |
| Loss from operations as a % of net revenue | (7.5)% | (26.7)% | (33.3)% |

The majority of the net revenue in Corporate Investments relates to network infrastructure products sold under the brand "ProCurve Networking." In fiscal 2007, revenue from network infrastructure products increased 33% compared to the same period in fiscal 2006 as new product introductions continued to drive increased sales of enterprise class gigabit Ethernet switch products.

Corporate Investments' loss from operations in fiscal 2007 was due primarily to expenses associated with corporate development, global alliances and HP Labs that are carried in the segment.

The year-over-year decrease in operating losses was driven primarily by higher earnings from operations generated by network infrastructure products.

In fiscal 2006, the majority of the net revenue in Corporate Investments related to network infrastructure products, which grew 8% from fiscal 2005 as a result of increased sales of gigabit Ethernet switch products.

Corporate Investments' loss from operations in fiscal 2006 decreased compared to fiscal 2005 due primarily to lower operating expenses related to global alliances and HP Labs and higher gross profits from network infrastructure products. The decrease in operating expenses was due primarily to savings resulting from restructuring actions and lower program spending. Expenses related to global alliances and HP Labs contributed to the majority of the loss from operations.

## LIQUIDITY AND CAPITAL RESOURCES

Our cash balances are held in numerous locations throughout the world, including substantial amounts held outside of the United States. Most of the amounts held outside of the United States could be repatriated to the United States but under current law would be subject to United States federal income taxes, less applicable foreign tax credits. Repatriation of some foreign balances is restricted by local laws. We have provided for the United States federal tax liability on these amounts for financial statement purposes, except for foreign earnings that are considered indefinitely reinvested outside of the United States. Repatriation could result in additional United States federal income tax payments in future years. Our intent is that most of the non-U.S. cash balances would remain outside of the United States and we would meet United States liquidity needs through ongoing cash flows, external borrowings, or both. We utilize a variety of tax planning and financing strategies in an effort to ensure that our worldwide cash or debt is available in the locations in which it is needed.

### *FINANCIAL CONDITION (Sources and Uses of Cash)*

Our total cash and cash equivalents declined approximately 31% to $11.3 billion at October 31, 2007 from $16.4 billion at October 31, 2006 due primarily to increased spending for repurchases of our common stock and investment spending on acquisitions, which spending was partially offset by positive operating cash flows and increased borrowings. The net $14.7 billion used for investing and financing activities during fiscal 2007 included $10.9 billion for share repurchases, $6.8 billion for cash payments in connection with acquisitions and $2.5 billion for net investments in property, plant and equipment. Partially offsetting these cash expenditures were $3.1 billion of proceeds relating to the issuance of stock under employee stock plans and a $2.6 billion net increase in our debt and commercial paper from increased borrowings. Our cash position remains strong, and we believe our cash balances are sufficient to cover cash outlays expected in fiscal 2008 associated with additional stock repurchases, acquisitions, company bonus payments, and other operating cash requirements.

| | For the fiscal years ended October 31 | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | In millions | | |
| Net cash provided by operating activities | $ 9,615 | $ 11,353 | $ 8,028 |
| Net cash used in investing activities | (9,123) | (2,787) | (1,757) |
| Net cash used in financing activities | (5,599) | (6,077) | (5,023) |
| Net (decrease) increase in cash and cash equivalents | $ (5,107) | $ 2,489 | $ 1,248 |

*Key Performance Metrics*

| | October 31 | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| Days of sales outstanding in accounts receivable | 43 | 40 | 39 |
| Days of supply in inventory | 34 | 38 | 35 |
| Days of purchases outstanding in accounts payable | (50) | (59) | (52) |
| Cash conversion cycle | 27 | 19 | 22 |

Days of sales outstanding in accounts receivable ("DSO") measures the average number of days our receivables are outstanding. DSO is calculated by dividing accounts receivable, net of allowance for doubtful accounts, by a 90-day average net revenue.

Days of supply in inventory ("DOS") measures the average number of days from procurement to sale of our product. DOS is calculated by dividing inventory by a 90-day average cost of goods sold.

Days of purchases outstanding in accounts payable ("DPO") measures the average number of days our accounts payable balances are outstanding. DPO is calculated by dividing accounts payable by a 90-day average cost of goods sold.

Our working capital requirements depend upon our effective management of the cash conversion cycle, which represents effectively the number of days that elapse from the day we pay for the purchase of raw materials to the collection of cash from our customers. The cash conversion cycle is the sum of DSO and DOS less DPO.

The increase in DSO was due primarily to selectively extending payment terms and reducing cash discount rates for early payments for certain customers. The decrease in DOS was due primarily to more efficient inventory management and higher cost of goods sold during the fourth quarter as a result of increased revenues. The decrease in DPO was due primarily to purchasing linearity and reduced payment terms and cash discounts from our major contract manufacturers. These changes contributed to the increase in our current year cash conversion cycle compared to the prior year.

**2007 Compared to 2006**

*Operating Activities*

Net cash provided by operating activities decreased by $1.7 billion during fiscal 2007 from fiscal 2006. The decrease was due primarily to an increase in accounts receivable, a decrease in accounts payable and higher payments for bonuses earned in fiscal 2006 and paid in the first quarter of fiscal 2007. The decease in our cash flow from operations was partially offset by higher earnings in fiscal 2007.

*Investing Activities*

Net cash used in investing activities increased by $6.3 billion in fiscal 2007 from fiscal 2006, due primarily to higher cash payments made in connection with acquisitions.

*Financing Activities*

Net cash used in financing activities decreased by $0.5 billion during fiscal 2007 from fiscal 2006. The decrease was due primarily to higher net issuance of commercial paper and debt, the impact of which was partially offset by increased repurchases of our common stock.

*Common Stock Repurchases*

We repurchase shares of our common stock under an ongoing program to manage the dilution created by shares issued under employee benefit plans as well as to repurchase shares opportunistically. This program authorizes repurchases in the open market or in private transactions. In fiscal 2007, we completed share repurchases of approximately 209 million shares. Repurchases of approximately 210 million shares were settled for $9.1 billion, which included approximately 1 million shares repurchased in transactions that were executed in fiscal 2006 but settled in fiscal 2007. In fiscal 2006, we completed share repurchases of approximately 188 million shares. Repurchases of approximately 190 million shares were settled for $6.1 billion in fiscal 2006, including 2 million shares repurchased in transactions that were executed in fiscal 2005 but settled in fiscal 2006.

In addition to the above transactions, we entered into an Accelerated Share Repurchase program (the "ASR Program") with a third-party investment bank during the second quarter of fiscal 2007. Pursuant to the terms of the ASR Program, we purchased 40 million shares of our common stock from the investment bank for $1.8 billion (the "Purchase Price") on March 30, 2007 (the "Purchase Date"). We decreased our shares outstanding and reduced the outstanding shares used to calculate the weighted-average common shares outstanding for both basic and diluted EPS on the Purchase Date. The shares delivered to us included shares that the investment bank borrowed from third parties. The investment bank purchased an equivalent number of shares in the open market to cover its position with respect to the borrowed shares during a contractually specified averaging period that began on the Purchase Date and ended on June 6, 2007. At the end of the averaging period, the investment bank's total purchase cost based on the volume weighted-average purchase price of our shares during the averaging period was approximately $90 million less than the Purchase Price. Accordingly, we had the option to receive either additional shares of our common stock or a cash payment in the amount of the difference from the investment bank. In June 2007, we received approximately 2 million additional shares purchased by the investment bank in the open market with a value approximately equal to that amount. We reduced our shares outstanding upon receipt of those shares.

Also, we entered into a prepaid variable share purchase program ("PVSPP") with a third-party investment bank during the first quarter of 2006 and prepaid $1.7 billion in exchange for the right to receive a variable number of shares of our common stock weekly over a one-year period beginning in the second quarter of fiscal 2006 and ending during the second quarter of fiscal 2007. We completed all repurchases under the PVSPP on March 9, 2007. As of that date, we had cumulatively received a total of 53 million shares. We retired all shares repurchased and no longer deem those shares outstanding.

We intend to continue to repurchase shares as a means to manage dilution from the issuance of shares under employee benefit plans and to purchase shares opportunistically. On March 15, 2007, our Board of Directors authorized an additional $8.0 billion for future share repurchases. As of October 31, 2007, we had remaining authorization of approximately $2.7 billion for future share repurchases. On November 19, 2007, our Board of Directors authorized an additional $8.0 billion for future share repurchases. For more information on our share repurchases, see Item 5 and Note 14 to the Consolidated Financial Statements in Item 8, which are incorporated herein by reference.

**2006 Compared to 2005**

*Operating Activities*

Net cash provided by operating activities increased by $3.3 billion during fiscal 2006. The increase in our cash flow from operations was due primarily to higher earnings and lower payments for pension and taxes, with the increase partially offset by higher payments for restructuring costs.

*Investing Activities*

Net cash used in investing activities increased by $1.0 billion during fiscal 2006 due primarily to higher capital expenditures for property, plant and equipment, lower net proceeds from maturities and sales of investments and higher amounts of cash paid for acquisitions.

*Financing Activities*

Net cash used in financing activities increased by $1.1 billion during fiscal 2006 from fiscal 2005. The increase was due primarily to a $2.5 billion increase in repurchases of common stock and a $1.7 billion prepayment for common stock to be repurchased in future periods. These expenditures were partially offset by a $1.6 billion net increase to financing activities resulting from higher borrowings and lower debt payments and $1.4 billion increased proceeds from the issuance of common stock related to our employee stock plans due mainly to increased exercises of employee stock options as a result of higher market prices for our common stock during fiscal 2006.

*Common Stock Repurchases*

In fiscal 2006, we completed share repurchases of approximately 188 million shares. Repurchases of approximately 190 million shares were settled for $6.1 billion, which included 2 million shares repurchased in transactions that were executed in fiscal 2005 but settled in fiscal 2006, as compared to approximately 150 million shares repurchased, of which 148 million shares were settled for $3.5 billion in fiscal 2005.

In addition to the shares we repurchased, we received approximately 34 million shares for an aggregate price of $1.1 billion under PVSPP as described above. Under the PVSPP, we prepaid $1.7 billion in the first quarter of fiscal 2006 in exchange for the right to receive a variable number of shares of our common stock weekly over a one-year period beginning in the second quarter of fiscal 2006 and ending during the second quarter of fiscal 2007. We recorded the payment as a prepaid stock repurchase in the stockholders' equity section of our Consolidated Balance Sheet and included the payment in the cash flows from financing activities in the Consolidated Statement of Cash Flows. In connection with this program, the investment bank purchased shares of our common stock in the open market over time. The prepaid funds were expended ratably over the term of the program.

During fiscal 2006, our Board of Directors authorized an additional $10.0 billion for future repurchases of our outstanding shares of common stock. As of October 31, 2006, we had remaining authorization of approximately $5.6 billion for future share repurchases.

***LIQUIDITY***

As previously discussed, we use cash generated by operations as our primary source of liquidity; we believe that internally generated cash flows are sufficient to support business operations, capital expenditures and the payment of stockholder dividends, in addition to a level of discretionary investments and share repurchases. We are able to supplement this near-term liquidity, if necessary, with broad access to capital markets and credit line facilities made available by various foreign and domestic financial institutions.

We maintain debt levels that we establish through consideration of a number of factors, including cash flow expectations, cash requirements for operations, investment plans (including acquisitions), share repurchase activities, and the overall cost of capital. Outstanding debt increased to $8.2 billion as of October 31, 2007 as compared to $5.2 billion at October 31, 2006, bearing weighted-average interest rates of 5.2% and 5.1%, respectively. Short-term borrowings increased to $3.2 billion at October 31, 2007 from $2.7 billion at October 31, 2006. The increase in short-term borrowings was due primarily to the net issuance of approximately $1.9 billion of our commercial paper and notes payable and the reclassification from long-term to short-term debt, including $500 million U.S. Dollar Global Notes that will mature in March 2008 and $50 million Series A Medium-Term Notes that matured and we repaid in December 2007. The increase was offset partially by our repayment of $1.0 billion Global Notes in December 2006 and $1.0 billion Global Notes in July 2007. During fiscal 2007, we issued $32 billion and repaid $30 billion of commercial paper. As of October 31, 2007, we had $5 million in total borrowings collateralized by certain financing receivable assets.

The majority of our outstanding debt relates to HPFS. We issue debt in order to finance HPFS and as needed for other purposes. HPFS has a business model that is asset-intensive in nature and therefore we fund HPFS more by debt than we fund our other business segments. At October 31, 2007, HPFS had approximately $8.3 billion in net portfolio assets, which included short- and long-term financing receivables and operating lease assets.

We have the following resources available to obtain short-term or long-term financings, if we need additional liquidity:

| | | At October 31, 2007 | |
|---|---|---|---|
| | Original amount available | Used | Available |
| | | In millions | |
| 2002 Shelf Registration Statement | | | |
| Debt, U.S. global securities and up to $1,500 of Series B Medium-Term Notes | $ 3,000 | $ 2,000 | $ 1,000 |
| Euro Medium-Term Notes | 3,000 | | 3,000 |
| Uncommitted lines of credit | 2,455 | 645[(1)] | 1,810 |
| Commercial paper programs | | | |
| U.S. | 6,000 | 1,821 | 4,179 |
| Euro | 500 | 244 | 256 |
| | $ 14,955 | $ 4,710 | $ 10,245 |

(1) Approximately $151 million of this amount was recorded as debt as of October 31, 2007; the remaining amount was used to satisfy business operational requirements.

In addition to the financing resources listed above, we had additional borrowing activities as described below.

In November 2006, in connection with the Mercury acquisition, we assumed notes issued by Mercury with a face value of $300 million, maturing on July 1, 2007 and bearing interest at a rate of

4.75% per annum (the "Mercury Notes"). As of July 31, 2007, we had repurchased or repaid at maturity all of the Mercury Notes.

In May 2006, we filed a shelf registration statement (the "2006 Shelf Registration Statement") with the Securities and Exchange Commission (the "SEC") to enable us to offer and sell from time to time, in one or more offerings, debt securities, common stock, preferred stock, depositary shares and warrants. On May 23, 2006, we issued $1.0 billion in floating rate global notes due May 22, 2009 under the 2006 Shelf Registration Statement that we redeemed in June 2007.

On February 22, 2007, we issued an additional $2.0 billion of global notes under the 2006 Shelf Registration Statement. The global notes included $600 million of notes due March 2012 with a floating interest rate equal to the three-month USD LIBOR plus 0.11% per annum, $900 million of notes due March 2012 with a fixed interest rate of 5.25% per annum and $500 million of notes due March 2017 with a fixed interest rate of 5.40% per annum. We issued the $600 million notes at par and the $900 million notes and $500 million notes at discounts to par at 99.938% and 99.694%, respectively. We used the net proceeds from these note offerings for general corporate purposes, including funding the repurchase of the Mercury Notes as described above and repaying short-term commercial paper.

On June 12, 2007, we issued an additional $2.0 billion of global notes under the 2006 Shelf Registration Statement. The global notes included $1.0 billion of notes due June 2009 with a floating interest rate equal to the three-month USD LIBOR plus 0.01% per annum, and $1.0 billion of notes due June 2010 with a floating interest rate equal to the three-month USD LIBOR plus 0.06% per annum. We issued these global notes at par. We used the net proceeds from these offerings for general corporate purposes, including the redemption of the floating rate global notes due May 22, 2009 as described above in June 2007 and the repayment of short-term commercial paper.

On December 17, 2007, we repaid $50 million Series A Medium-Term Notes due December 2007 at maturity.

We have a $3.0 billion U.S. credit facility expiring in May 2012. This credit facility is a senior unsecured committed borrowing arrangement that we put in place primarily to support our U.S. commercial paper program. Our ability to have a U.S. commercial paper outstanding balance that exceeds the $3.0 billion committed credit facility is subject to a number of factors, including liquidity conditions and business performance.

Our credit risk is evaluated by three independent rating agencies based upon publicly available information as well as information obtained in our ongoing discussions with them. Standard & Poor's Ratings Services, Moody's Investors Service and Fitch Ratings currently rate our senior unsecured long-term debt A, A2 and A+ and our short-term debt A-1, Prime-1 and F1, respectively. We do not have any rating downgrade triggers that would accelerate the maturity of a material amount of our debt. However, a downgrade in our credit rating would increase the cost of borrowings under our credit facilities. Also, a downgrade in our credit rating could limit our ability to issue commercial paper under our current programs. If this occurs, we would seek alternative sources of funding, including through drawdowns under our credit facility or the issuance of notes under our existing shelf registration statements and our Euro Medium-Term Note Programme.

We have revolving trade receivables-based facilities permitting us to sell certain trade receivables to third parties on a non-recourse basis. The aggregate maximum capacity under these programs was approximately $525 million as of October 31, 2007. We sold approximately $2.2 billion of trade receivables during fiscal 2007. As of October 31, 2007, we had approximately $117 million available under these programs.

*Contractual Obligations*

The impact that we expect our contractual obligations as of October 31, 2007 to have on our liquidity and cash flow in future periods is as follows:

| | | Payments Due by Period | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years |
| | | | In millions | | |
| Long-term debt, including capital lease obligations[1] | $ 5,827 | $ 683 | $ 2,059 | $ 2,012 | $ 1,073 |
| Operating lease obligations | 2,193 | 595 | 761 | 409 | 428 |
| Purchase obligations[2] | 2,029 | 1,826 | 164 | 24 | 15 |
| Total | $ 10,049 | $ 3,104 | $ 2,984 | $ 2,445 | $ 1,516 |

(1) Amounts represent the expected cash payments of our long-term debt and do not include any fair value adjustments or discounts. Included in our long-term debt are approximately $48 million of capital lease obligations that are secured by certain equipment.

(2) Purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on us and that specify all significant terms, including fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty. These purchase obligations are related principally to inventory and other items.

*Funding Commitments*

During fiscal 2007, we made approximately $133 million of contributions to non-U.S. pension plans, paid $16 million to cover benefit payments to U.S. non-qualified plan participants, and paid $58 million to cover benefit claims under post-retirement benefit plans. In addition, we used $108 million of cash to fund the distribution and subsequent transfer of accrued pension benefits from the U.S. Excess Benefit Plan to the U.S. Executive Deferred Compensation Plan for the terminated vested plan participants. In fiscal 2008, we expect to contribute approximately $145 million to our pension plans and approximately $15 million to cover benefit payments to U.S. non-qualified plan participants. We also expect to pay approximately $80 million to cover benefit claims for our post-retirement benefit plans in fiscal 2008. Our funding policy is to contribute cash to our pension plans so that we meet at least the minimum contribution requirements, as established by local government and funding and taxing authorities. We expect to use contributions made to the post-retirement benefit plans primarily for the payment of retiree health claims incurred during the fiscal year.

In conjunction with our February 2007 announcement to modify our U.S. defined benefit pension plan and our Pre-2003 Retiree Medical Program, we offered eligible affected employees an option to participate in the 2007 EER. We funded the cash expenditures associated with the 2007 EER primarily by using available U.S. pension plan assets. We made no incremental pension contributions to the pension plan stemming from the 2007 EER.

We have implemented bonus programs that are designed to reward our employees upon achievement of annual performance objectives. We calculate bonuses based on a formula, with targets that are set at the beginning of each fiscal year. Our Board of Directors approves both the formula and the targets.

In fiscal 2007, we outperformed against our targets, which will result in a significant bonus payout during the first quarter of fiscal 2008 and a corresponding reduction of cash flow from operations in that quarter. We accrued and expensed this bonus, as it was earned, throughout fiscal 2007.

As a result of our approved restructuring plans, we expect future cash expenditures of $173 million, which we recorded on our Consolidated Balance Sheet at October 31, 2007. We expect to make cash payments of approximately $123 million in fiscal 2008 and the majority of the remaining $50 million through 2014.

*Pending and Subsequent Acquisitions*

For pending acquisitions, see Note 6 to the Consolidated Financial Statements in Item 8, which is incorporated herein by reference.

*Off-Balance Sheet Arrangements*

As part of our ongoing business, we do not participate in transactions that generate material relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities ("SPEs"), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of October 31, 2007, we are not involved in any material unconsolidated SPEs.

*Indemnifications*

In the ordinary course of business, we enter into contractual arrangements under which we may agree to indemnify the third-party to such arrangement from any losses incurred relating to the services they perform on behalf of us or for losses arising from certain events as defined within the particular contract, which may include, for example, litigation or claims relating to past performance. Such indemnification obligations may not be subject to maximum loss clauses. Historically, payments we have made related to these indemnifications have been immaterial.

**ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk.**

In the normal course of business, we are exposed to foreign currency exchange rate, interest rate and equity price risks that could impact our financial position and results of operations. Our risk management strategy with respect to these three market risks may include the use of derivative financial instruments. We use derivative contracts only to manage existing underlying exposures of HP. Accordingly, we do not use derivative contracts for speculative purposes. Our risks, risk management strategy and a sensitivity analysis estimating the effects of changes in fair values for each of these exposures are outlined below.

Actual gains and losses in the future may differ materially from the sensitivity analyses based on changes in the timing and amount of interest rate, foreign currency exchange rate and equity price movements and our actual exposures and hedges.

*Foreign currency exchange rate risk*

We are exposed to foreign currency exchange rate risk inherent in our sales commitments, anticipated sales, anticipated purchases and assets, liabilities and debt denominated in currencies other than the U.S. dollar. We transact business in approximately 40 currencies worldwide, of which the most significant to our operations for fiscal 2007 were the euro, the Japanese yen and the British pound. For most currencies, we are a net receiver of the foreign currency and therefore benefit from a weaker U.S. dollar and are adversely affected by a stronger U.S. dollar relative to the foreign currency. Even where we are a net receiver, a weaker U.S. dollar may adversely affect certain expense figures taken alone. We use a combination of forward contracts and options designated as cash flow hedges to protect against the foreign currency exchange rate risks inherent in our forecasted net revenue and, to a lesser extent, cost of sales denominated in currencies other than the U.S. dollar. In addition, when debt is denominated in a foreign currency, we may use swaps to exchange the foreign currency principal and interest obligations for U.S. dollar-denominated amounts to manage the exposure to changes in foreign currency exchange rates. We also use other derivatives not designated as hedging instruments under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," consisting primarily of forward contracts to hedge foreign currency balance sheet exposures. We recognize the gains and losses on foreign currency forward contracts in the same period as the remeasurement losses and gains of the related foreign currency-denominated exposures. Alternatively, we may choose not to hedge the foreign currency risk associated with our foreign currency exposures if such exposure acts as a natural foreign currency hedge for other offsetting amounts denominated in the same currency or the currency is difficult or too expensive to hedge.

We have performed sensitivity analyses as of October 31, 2007 and 2006, using a modeling technique that measures the change in the fair values arising from a hypothetical 10% adverse movement in the levels of foreign currency exchange rates relative to the U.S. dollar, with all other variables held constant. The analyses cover all of our foreign currency contracts offset by the underlying exposures. The foreign currency exchange rates we used were based on market rates in effect at October 31, 2007 and 2006. The sensitivity analyses indicated that a hypothetical 10% adverse movement in foreign currency exchange rates would result in a foreign exchange loss of $104 million at both October 31, 2007 and October 31, 2006.

*Interest rate risk*

We also are exposed to interest rate risk related to our debt and investment portfolios and financing receivables. We issue long-term debt in either U.S. dollars or foreign currencies based on market conditions at the time of financing. We then typically use interest rate and/or currency swaps to modify the market risk exposures in connection with the debt to achieve primarily U.S. dollar LIBOR-based floating interest expense. The swap transactions generally involve the exchange of fixed for floating interest payments. However, we may choose not to swap fixed for floating interest payments or may terminate a previously executed swap if we believe a larger proportion of fixed-rate debt would be beneficial. In order to hedge the fair value of certain fixed-rate investments, we may enter into interest rate swaps that convert fixed interest returns into variable interest returns. We may use cash flow hedges to hedge the variability of LIBOR-based interest income received on certain variable-rate investments. We may also enter into interest rate swaps that convert variable rate interest returns into fixed-rate interest returns.

We have performed sensitivity analyses as of October 31, 2007 and 2006, using a modeling technique that measures the change in the fair values arising from a hypothetical 10% adverse movement in the levels of interest rates across the entire yield curve, with all other variables held constant. The analyses cover our debt, investment instruments, financing receivables and interest rate swaps. The analyses use actual maturities for the debt, investments and interest rate swaps and approximate maturities for financing receivables. The discount rates we used were based on the market interest rates in effect at October 31, 2007 and 2006. The sensitivity analyses indicated that a hypothetical 10% adverse movement in interest rates would result in a loss in the fair values of our debt and investment instruments and financing receivables, net of interest rate swap positions, of $17 million at October 31, 2007 and $19 million at October 31, 2006.

*Equity price risk*

We are also exposed to equity price risk inherent in our portfolio of publicly-traded equity securities, which had an estimated fair value of $9 million at October 31, 2007 and $36 million at October 31, 2006. We monitor our equity investments for impairment on a periodic basis. In the event that the carrying value of the equity investment exceeds its fair value, and we determine the decline in value to be other than temporary, we reduce the carrying value to its current fair value. Generally, we do not attempt to reduce or eliminate our market exposure on these equity securities. However, we may use derivative transactions to hedge certain positions from time to time. We do not purchase our equity securities with the intent to use them for speculative purposes. A hypothetical 30% adverse change in the stock prices of our publicly-traded equity securities would result in a loss in the fair values of our marketable equity securities of $3 million at October 31, 2007 and $11 million at October 31, 2006. The aggregate cost of privately-held companies and other investments was $533 million at October 31, 2007 and $362 million at October 31, 2006.

**ITEM 8. Financial Statements and Supplementary Data.**

**Table of Contents**

## Report of Independent Registered Public Accounting Firm

**To the Board of Directors and Stockholders of**
**Hewlett-Packard Company**

We have audited the accompanying consolidated balance sheets of Hewlett-Packard Company and subsidiaries as of October 31, 2007 and 2006, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three years in the period ended October 31, 2007. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Hewlett-Packard Company and subsidiaries at October 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended October 31, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Hewlett-Packard Company's internal control over financial reporting as of October 31, 2007, based on criteria established in Internal Control  Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated December 14, 2007 expressed an unqualified opinion thereon.

As discussed in Note 1 to the consolidated financial statements, in fiscal year 2007, Hewlett-Packard Company changed its method of accounting for defined benefit postretirement plans in accordance with the guidance provided in Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans  An Amendment of FASB No. 87, 88, 106 and 132(R)" and, in fiscal year 2006, changed its method of accounting for stock-based compensation in accordance with guidance provided in Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment".

/s/ ERNST & YOUNG LLP

San Jose, California
December 14, 2007

## Report of Independent Registered Public Accounting Firm

**To the Board of Directors and Stockholders of**
**Hewlett-Packard Company**

We have audited Hewlett-Packard Company's internal control over financial reporting as of October 31, 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Hewlett-Packard Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Hewlett-Packard Company maintained, in all material respects, effective internal control over financial reporting as of October 31, 2007 based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated balance sheets of Hewlett-Packard Company and subsidiaries as of October 31, 2007 and 2006, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three years in the period ended October 31, 2007 and our report dated December 14, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Jose, California
December 14, 2007

**Management's Report on Internal Control Over Financial Reporting**

HP's management is responsible for establishing and maintaining adequate internal control over financial reporting for HP. HP's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. HP's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of HP; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of HP are being made only in accordance with authorizations of management and directors of HP; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of HP's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

HP's management assessed the effectiveness of HP's internal control over financial reporting as of October 31, 2007, utilizing the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on the assessment by HP's management, we determined that HP's internal control over financial reporting was effective as of October 31, 2007. The effectiveness of HP's internal control over financial reporting as of October 31, 2007 has been audited by Ernst & Young LLP, HP's independent registered public accounting firm, as stated in their report which appears on page 73 of this Annual Report on Form 10-K.

| | |
|---|---|
| /s/ MARK V. HURD | /s/ CATHERINE A. LESJAK |
| Mark V. Hurd | Catherine A. Lesjak |
| *Chairman, Chief Executive Officer and President* | *Executive Vice President and Chief Financial Officer* |
| December 14, 2007 | December 14, 2007 |

**HEWLETT-PACKARD COMPANY AND SUBSIDIARIES**

**Consolidated Statements of Earnings**

| | For the fiscal years ended October 31 | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| | In millions, except per share amounts | | |
| Net revenue: | | | |
| Products | $ 84,229 | $ 73,557 | $ 68,945 |
| Services | 19,699 | 17,773 | 17,380 |
| Financing income | 358 | 328 | 371 |
| Total net revenue | 104,286 | 91,658 | 86,696 |
| Costs and expenses: | | | |
| Cost of products | 63,435 | 55,248 | 52,550 |
| Cost of services | 15,163 | 13,930 | 13,674 |
| Financing interest | 289 | 249 | 216 |
| Research and development | 3,611 | 3,591 | 3,490 |
| Selling, general and administrative | 12,226 | 11,266 | 11,184 |
| Amortization of purchased intangible assets | 783 | 604 | 622 |
| In-process research and development charges | 190 | 52 | 2 |
| Restructuring charges | 387 | 158 | 1,684 |
| Pension curtailments and pension settlements, net | (517) | | (199) |
| Total operating expenses | 95,567 | 85,098 | 83,223 |
| Earnings from operations | 8,719 | 6,560 | 3,473 |
| Interest and other, net | 444 | 606 | 83 |
| Gains (losses) on investments | 14 | 25 | (13) |
| Earnings before taxes | 9,177 | 7,191 | 3,543 |
| Provision for taxes | 1,913 | 993 | 1,145 |
| Net earnings | $ 7,264 | $ 6,198 | $ 2,398 |
| Net earnings per share: | | | |
| Basic | $ 2.76 | $ 2.23 | $ 0.83 |
| Diluted | $ 2.68 | $ 2.18 | $ 0.82 |
| Weighted-average shares used to compute net earnings per share: | | | |
| Basic | 2,630 | 2,782 | 2,879 |
| Diluted | 2,716 | 2,852 | 2,909 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

**HEWLETT-PACKARD COMPANY AND SUBSIDIARIES**

**Consolidated Balance Sheets**

| | October 31 2007 | October 31 2006 |
|---|---|---|
| | In millions, except par value | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 11,293 | $ 16,400 |
| Short-term investments | 152 | 22 |
| Accounts receivable | 13,420 | 10,873 |
| Financing receivables | 2,507 | 2,440 |
| Inventory | 8,033 | 7,750 |
| Other current assets | 11,997 | 10,779 |
| Total current assets | 47,402 | 48,264 |
| Property, plant and equipment | 7,798 | 6,863 |
| Long-term financing receivables and other assets | 7,647 | 6,649 |
| Goodwill | 21,773 | 16,853 |
| Purchased intangible assets | 4,079 | 3,352 |
| Total assets | $ 88,699 | $ 81,981 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Notes payable and short-term borrowings | $ 3,186 | $ 2,705 |
| Accounts payable | 11,787 | 12,102 |
| Employee compensation and benefits | 3,465 | 3,148 |
| Taxes on earnings | 1,891 | 1,905 |
| Deferred revenue | 5,025 | 4,309 |
| Accrued restructuring | 123 | 547 |
| Other accrued liabilities | 13,783 | 11,134 |
| Total current liabilities | 39,260 | 35,850 |
| Long-term debt | 4,997 | 2,490 |
| Other liabilities | 5,916 | 5,497 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, $0.01 par value (300 shares authorized; none issued) | | |
| Common stock, $0.01 par value (9,600 shares authorized; 2,580 and 2,732 shares issued and outstanding, respectively) | 26 | 27 |
| Additional paid-in capital | 16,381 | 17,966 |
| Prepaid stock repurchase | | (596) |
| Retained earnings | 21,560 | 20,729 |
| Accumulated other comprehensive income | 559 | 18 |
| Total stockholders' equity | 38,526 | 38,144 |
| Total liabilities and stockholders' equity | $ 88,699 | $ 81,981 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

**HEWLETT-PACKARD COMPANY AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows**

| | For the fiscal years ended October 31 | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| | | **In millions** | |
| Cash flows from operating activities: | | | |
| Net earnings | $ 7,264 | $ 6,198 | $ 2,398 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | | |