HEWLETT PACKARD CO
Form PRRN14A
January 14, 2002

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SCHEDULE 14A
(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934
(Amendment No. 1)

Filed by the Registrant o

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Check the appropriate box:

x Preliminary Proxy Statement
o Definitive Proxy Statement
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HEWLETT-PACKARD COMPANY

(Name of Registrant as Specified In Its Charter)

WALTER B. HEWLETT, EDWIN E. VAN BRONKHORST AND THE WILLIAM R. HEWLETT REVOCABLE TRUST

(Name of Person(s) Filing Proxy Statement, if Other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

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o (1) Amount Previously Paid:

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Subject To Completion, Dated January 14, 2002

SPECIAL MEETING OF STOCKHOLDERS OF

HEWLETT-PACKARD COMPANY

, 2002

PROXY STATEMENT OF

WALTER B. HEWLETT

EDWIN E. VAN BRONKHORST

THE WILLIAM R. HEWLETT REVOCABLE TRUST

This proxy statement and the enclosed [GREEN] proxy card are being furnished to you, the stockholders of Hewlett-Packard Company (HP), in connection with the solicitation of proxies by Walter B. Hewlett, Edwin E. van Bronkhorst and The William R. Hewlett Revocable Trust (the Trust) for use at the Special Meeting of stockholders of HP, and at any adjournments or postponements thereof (the Special Meeting). Pursuant to this proxy statement, we are soliciting proxies from holders of shares of HP common stock to vote **AGAINST** the proposal to issue shares of HP common stock in connection with the proposed merger involving HP and Compaq Computer Corporation (Compaq).

The Special Meeting will be held on , , 2002 at 0:00 .m. Pacific Time at the , California.

* * * * * * *

A proxy may be given by any person who held shares of HP common stock on , 2002, the record date for the Special Meeting. Whether or not you plan to attend the Special Meeting, you are urged to sign and date the enclosed [GREEN] proxy card and return it in the postage-paid envelope provided. Your latest-dated proxy is the only one that counts, so you may return the [GREEN] proxy card even if you have already delivered a proxy. Please do not return any proxy sent to you by HP. If you have already returned a proxy card sent to you by HP, that card will be automatically revoked if you complete and return the enclosed [GREEN] proxy card.

This proxy statement is provided by Walter B. Hewlett, Edwin E. van Bronkhorst and The William R. Hewlett Revocable Trust and not by the Board of Directors of HP.

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This proxy statement and the enclosed [GREEN] proxy card are first being sent or given to stockholders of HP on or about , 2002.

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BACKGROUND OF THE DECISION TO OPPOSE THE PROPOSED MERGER

Walter Hewlett has been a director of HP for more than 14 years and has been involved with HP in various ways for most of his life. Mr. Hewlett is a graduate of Harvard University and has received graduate degrees from Stanford University. He is a member of the Board of Overseers of Harvard University and is also a member of the board of directors of Agilent Technologies, Inc. Mr. Hewlett has always had enormous respect for HP, for the outstanding achievements of its management and employees and for the culture of innovation and integrity that has contributed to its outstanding success. As a stockholder and director of HP, Mr. Hewlett believes that the HP Board owes a duty to pursue stockholder value and to guide HP to profitable growth for the benefit of its stockholders and employees. His decision to solicit your proxy is entirely motivated by what he believes is in the best interests of stockholders from a financial perspective.

Edwin E. van Bronkhorst is a former Chief Financial Officer of HP and co-trustee of the Trust with Mr. Hewlett. The Trust is a charitable trust set up by William R. Hewlett that owns approximately 72.8 million shares of HP common stock.

Mr. Hewlett was first made aware that Ms. Carleton Fiorina, Chairman and Chief Executive Officer of HP, was discussing a transaction with Compaq at an HP Board meeting in May 2001. For the next three months at subsequent Board meetings he carefully considered the merits of the proposed transaction. During these meetings, he voiced his concerns to his fellow directors when the proposal was discussed. These concerns were, and still are, focused on his belief that **the proposed merger will permanently destroy stockholder value**. He does not believe HP should dilute its stockholders ownership in the imaging and printing business and increase their exposure to the mature and unprofitable PC business. He also believes that mergers involving computing companies have consistently destroyed stockholder value, and that HP should not expose its stockholders to that risk.

Despite Mr. Hewlett s vocal opposition, Ms. Fiorina and the rest of the HP Board continued to pursue the proposed merger, culminating in HP Board meetings at the end of August and the beginning of September 2001 to approve the terms of the proposed merger. At these meetings, Mr. Hewlett and other members of the HP Board were kept apprised of:

- the status of negotiations between HP and Compaq,
- the views of HP s advisors,
- the status of negotiations with respect to the post-merger management structure of the combined company, and
- the significant multi-year compensation packages contemplated to be given to Ms. Fiorina, Michael D. Capellas, Chairman and Chief Executive Officer of Compaq, and other members of senior management following the proposed merger.

Mr. Hewlett continued to express his view that the proposed merger was not the appropriate course for HP at these meetings.

On August 31, 2001, just three days before the HP Board was asked to vote on the merger agreement, at an HP Board Meeting, Larry Sonsini, HP s outside legal counsel, informed the HP Board that the merger agreement being presented to the Board required unanimous approval by the HP Board. Mr. Hewlett then made clear to the entire Board that the unanimous vote requirement put him in a very difficult position, as he was not persuaded that the proposed merger was in the best interests of HP or its stockholders. At this point in time, Mr. Hewlett understood that the only major open issue was the exchange ratio (that is, the price HP would pay for Compaq). Additionally, all of the directors were told that HP and Compaq were still vigorously negotiating over the exchange ratio.

Mr. Sonsini then asked to speak with Mr. Hewlett outside the presence of the rest of the Board members. During this discussion, Mr. Sonsini informed Mr. Hewlett that HP was going to proceed with the proposed merger whether or not Mr. Hewlett voted in favor of it as a director. Mr. Hewlett then asked Mr. Sonsini whether he could abstain from the director vote. Mr. Sonsini advised Mr. Hewlett that he could not abstain under the existing terms of the merger agreement. Mr. Sonsini also advised Mr. Hewlett that, even if he voted to approve the proposed merger as a Board member, he could still vote against it as a stockholder. Mr. Hewlett knew that if he voted against the proposed merger, the provision regarding unanimous approval of the HP Board would have to be amended. Given Mr. Hewlett s understanding that the exchange ratio was the only significant open issue and that HP and Compaq were vigorously negotiating over the exchange ratio, and in light of Mr. Hewlett s conversation with Mr. Sonsini, Mr. Hewlett believed that if he voted against the proposed merger, HP would have to pay a higher price for Compaq. Since, based on his conversation with Mr. Sonsini, Mr. Hewlett believed the proposed merger was certain to be approved by the Board without his vote and because he believed it was in the best interests of HP stockholders to negotiate the best possible price for Compaq if the proposed merger were to be submitted to a stockholder vote, Mr. Hewlett determined to vote for the proposed transaction as a director and give stockholders the opportunity to make their own decision.

On Monday, September 3, 2001, during the telephone call in which the proposed merger was approved by the HP Board, Mr. Hewlett informed the Board that he might not support the proposed merger as a stockholder, and that, if the vote were to occur on that day, he would vote against the proposed merger as a stockholder. Mr. Hewlett intended to oppose the proposed merger as a stockholder at that time due to his concerns as described above. His concerns have only strengthened since that time as the market and analysts have reacted negatively to the transaction, the Hewlett Foundation s independent stock committee and the Packard Foundation, after careful analysis, made their announcements regarding their intentions to vote against the proposed merger, and Mr. Hewlett s financial advisor provided the Trust with its report with respect to the proposed merger.

The proposed merger was announced in the late evening on September 3, 2001. On the day after the announcement, HP s share price dropped from $23.21 to $18.87, a decline of 18.7% and an aggregate loss of approximately $8.5 billion of stockholder value. Shortly thereafter, negative commentary from industry analysts began. HP management then spent two months actively promoting the proposed merger in numerous presentations to institutional stockholders. Notwithstanding these presentations and HP management s active promotion of the proposed merger, the share price continued to fall, reaching $16.89 on November 5, 2001, a decline of 27.2% from the pre-announcement price, an aggregate loss of approximately $12.3 billion. During the same time, an index of comparable companies (consisting of Accenture Ltd, Apple Computer, Inc. Computer Sciences Corporation, Dell Computer Corporation, Electronic Data Systems Corporation, EMC Corporation, Gateway, Inc., International Business Machines Corporation, KPMG International, Network Appliance, Inc. and Sun Microsystems, Inc.) increased 9.9%. These comparable companies are the same companies used by Goldman Sachs in performing its Selected Companies Analysis in connection with rendering its fairness opinion to HP.

Mr. Hewlett s concerns about the proposed merger were confirmed by the market reaction to the announcement, which Mr. Hewlett viewed as a sign of significant stockholder dissatisfaction with the proposed merger. Additionally, many Wall Street analysts and industry experts publicly concurred with Mr. Hewlett s negative assessment of the proposed merger.

Mr. Hewlett s interests in the HP stockholder vote on the proposed merger are primarily as a fiduciary of the Trust and as Chairman of the William and Flora Hewlett Foundation (the Hewlett Foundation), which collectively own approximately 109.3 million shares (5.6%) of HP common stock worth approximately $2.5 billion as of January 10, 2002. The Hewlett Foundation and the Trust were established to support charitable endeavors, and, as significant HP stockholders, they are strictly focused on the value of the HP common stock. As a director of HP, Mr. Hewlett is similarly focused on maximizing stockholder value.

After the proposed merger was announced, the independent stock committee of the Hewlett Foundation, which is responsible for all voting and investment decisions with respect to HP common stock held by the Hewlett Foundation, undertook an analysis of the proposed merger to determine how it would affect the value of the Hewlett Foundation s shares. The independent stock committee includes no Hewlett family members or HP employees or directors.

Mr. Hewlett and his co-trustee of the Trust, Edwin E. van Bronkhorst, were advised by counsel to the Trust that, although the Trust could independently determine how to vote on the proposed merger, the Trust should give serious consideration to the decision of the Hewlett Foundation s independent stock committee on the vote, since the terms of the Trust require that all of the Trust s HP shares (or the proceeds from their sale) be distributed to the Hewlett Foundation. To further inform their decision, the trustees of the Trust engaged Friedman Fleischer & Lowe, LLC (FFL), a San Francisco investment firm, to independently evaluate the proposed merger on behalf of the Trust.

The independent stock committee asked Laurance R. Hoagland, the Hewlett Foundation s Chief Investment Officer and former President and Chief Executive Officer of Stanford Management Company, which oversees Stanford University s $10.0 billion investment portfolio, to analyze the proposed merger. Mr. Hoagland was aware that Mr. Hewlett was opposed to the merger as an individual stockholder, that the Trust s counsel had advised it to give serious consideration to the independent stock committee s decision and that the Trust, for which Mr. Hewlett and Mr. van Bronkhorst serve as trustees, had not yet determined how it was going to vote its shares with respect to the proposed merger. Mr. Hewlett confirmed to Mr. Hoagland that he understood that Mr. Hoagland would prepare his recommendations to the committee, and that the committee would decide how to vote the Foundation s HP shares, independently of Mr. Hewlett s views as an individual stockholder.

The Hewlett Foundation s independent stock committee, considering among other things the advice of Mr. Hoagland and the various industry experts and investment professionals he consulted, concluded that the proposed merger was not in the Hewlett Foundation s best interests and determined that it would vote against the proposed merger. Mr. Hewlett had no discussions with any member of the independent stock committee regarding his views on the proposed merger prior to its reaching its determination. Ms. Fiorina and Mr. Wayman did, however, meet with the Hewlett Foundation s investment staff, including Mr. Hoagland, regarding the proposed merger before Mr. Hoagland made his recommendation to the independent stock committee. The independent stock committee made its own determination as to the timing of its decision with respect to the proposed merger. The independent stock committee s decision was then reported to the Hewlett Foundation board and to Walter Hewlett and Edwin E. van Bronkhorst, as trustees of the William R. Hewlett Revocable Trust. Thereafter, Walter Hewlett and Edwin E. van Bronkhorst, considering among other things the advice of FFL and the decision of the independent stock committee, concluded that the proposed merger was not in the Trust s best interests and determined to vote the Trust s shares against the proposed merger.

With two separate independent financial analyses in hand, each clearly reinforcing the reaction of the market, Mr. Hewlett determined that it was in HP s stockholders best interests to make his views known publicly in an effort to terminate the transaction as soon as possible and avoid exposing HP to continued uncertainty about its future. On November 6, 2001, he announced that the Hewlett Foundation, the Trust, his sisters Eleanor Hewlett Gimon and Mary Hewlett Jaffe and he would all vote against the proposed merger. Later that same day, David Woodley Packard separately announced that he too was against the proposed merger and would vote his HP shares against the proposed merger. Once again, the market reinforced Mr. Hewlett s belief that the proposed merger was not beneficial for HP HP shares rose from $16.89 to $19.81, or 17.3%, gaining $5.7 billion in aggregate market value on the day of Mr. Hewlett s announcement.

HP s largest stockholder, The David and Lucile Packard Foundation (the Packard Foundation), which owns approximately 201.3 million shares (10.4%) of HP common stock worth approximately $4.7 billion as of January 10, 2001, conducted its own process, independent of Mr. Hewlett, to determine how to vote its shares on the proposed merger. We understand that this decision process involved the full Board of the Packard Foundation, which consists of five members of the Packard family and seven other directors, including a former chief executive officer and a former chief operating officer of HP. We understand that the Packard Foundation retained technology and management consulting firm Booz-Allen & Hamilton (BAH) to assist it in determining how to vote its shares. We further understand that BAH and members of the Packard Foundation Board met with senior members of both HP and Compaq management, including Ms. Fiorina, Robert P. Wayman, Executive Vice President, Finance and Administration and Chief Financial Officer of HP, and Mr. Capellas, to discuss the proposed merger. Mr. Hewlett also met with members of the Packard Foundation to discuss his views on the proposed merger. On December 7, 2001, the Packard Foundation announced the preliminary decision of its Board to vote against the proposed merger; we understand that this decision was by a unanimous vote of the Packard Foundation Board.

By December 7, 2001, the independent stock committee of the Hewlett Foundation, 12 directors of the Packard Foundation and the trustees of the Trust had all determined that the proposed merger was not in their best interests. These interests represent approximately 16.1% of the outstanding HP common stock.

Despite the substantial stockholder and investment community opposition, Ms. Fiorina s public statements, and those of several other members of the HP Board, are to the effect that they are determined to take the transaction to a vote. It should be noted that under the HP/ Compaq merger agreement, HP is contractually obligated to use its reasonable efforts to support the merger and obtain its approval, and the HP Board is obligated to recommend the proposed merger to HP s stockholders and is prohibited from changing its recommendation unless a superior offer for HP emerges. If a superior offer for HP emerges, the HP Board could change its recommendation, in which event Compaq would be entitled to terminate the merger agreement and obtain from HP a $675 million breakup fee. On the other hand, if the proposed merger is taken to a vote and not approved by HP stockholders, HP can terminate the agreement at its option and would not be obligated to pay Compaq any breakup fee. Additionally, if HP and Compaq were to mutually agree to terminate the proposed merger, no break up fee would be payable.

Mr. Hewlett remains determined to stop the proposed merger. His opposition is based on his firm commitment to stockholder value and his firm belief, shared by the Hewlett Foundation, the Packard Foundation, many other stockholders, many HP employees and many Wall Street analysts, that the proposed merger is not in the best interests of HP s stockholders. To that end, we are soliciting your proxy to vote **AGAINST** the proposed merger.

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REASONS TO VOTE AGAINST THE PROPOSED MERGER

The following is a summary of what we believe to be the consequences of the proposed merger. They are the primary reasons why we believe stockholders should vote **AGAINST** the issuance of shares of HP common stock in connection with the proposed merger. **Damage to HP s business is being done now while the uncertainty of the proposed merger continues.** In this regard, we note that a January 4, 2002, USA Today article stated that: (i) studies show that most HP and Compaq customers disapprove of the proposed merger; (ii) customers are considering buying or leasing products from other companies or holding off purchases because of the proposed merger; (iii) customers are concerned that layoffs at the merged company could lead to service problems; and (iv) Dell Computer may have already reaped benefits from the uncertainty surrounding the proposed merger.

We urge you to demonstrate your opposition and send a message to the HP Board by signing, dating and returning the enclosed [GREEN] proxy card as soon as possible.

HP S BUSINESS PORTFOLIO WILL BE WORSE. The proposed merger would significantly dilute HP stockholders interest in the profitable imaging and printing business, and significantly increase their exposure to an unprofitable PC business. **The combined company would be weaker, not stronger, than HP.**

HP S STRATEGIC POSITION WILL NOT MATERIALLY IMPROVE. The proposed merger would: (i) dramatically increase HP s market position in unattractive low-end, commodity businesses, such as PCs and low-end servers; (ii) not materially improve HP s market position in mid-range and high-end servers and high-end services, which have higher profit margins than the profit margins for PCs; (iii) divert management s attention and financial resources from HP s preeminent imaging and printing business; and (iv) do little to increase HP s consulting and outsourcing capabilities.

THE INTEGRATION RISK OF THE PROPOSED MERGER IS SUBSTANTIAL. No significant combination involving a computer company has ever met expectations. The odds are against success in this merger. The complexity of putting two companies together, in a difficult economy, when each company is currently undergoing its own transition, presents daunting challenges and unacceptable risks. Management has no experience or track record with a merger of this scale. Even if the targeted cost synergies are achieved, it is likely that merger-related revenue losses will offset or exceed them.

THE FINANCIAL IMPACT ON HP STOCKHOLDERS HAS BEEN AND WILL BE NEGATIVE. From the date the proposed merger was announced through January 10, 2002, HP stockholders have lost $11.2 billion relative to an index of comparable companies. The market has twice made resoundingly clear that this combination destroys value for HP stockholders once when HP s stock price dramatically declined after the proposed merger was announced and again when HP s stock price dramatically increased after we made our opposition to the proposed merger public. In addition, the dramatic reduction in the earnings outlook for Compaq since the announcement of the proposed merger means that HP stockholders are getting too little of the combined company relative to HP s contribution to earnings. It also transforms what HP s management claims to be an accretive transaction into a dilutive transaction when revenue losses more in line with historical experience in prior transactions and analysts estimates (up to 17% in 2003) are factored in. Further, when compared to a standalone HP, the combined company represents a weaker credit with greater equity risk and a higher cost of capital.

HP is a great company. It is currently profitable when many other IT companies are losing money. HP has the market-leading position in the very attractive imaging and printing market, a great consumer brand name, a strong reputation with enterprise customers, and a prodigious source of innovation in HP Labs. HP faces challenges in some of its business segments, but these challenges were known before this transaction, and management needs to focus all of its attention on resolving them. Management has said this is not a defensive transaction and that a defensive transaction is not needed at HP. We agree.

We profoundly disagree, however, with management s assertion that HP needs to make this large and very risky acquisition. To undertake the proposed merger is to make a big, long-term, bet-the-company move. It worsens the HP stockholders portfolio of businesses. It does not solve key strategic problems. It creates enormous immediate risk and intermediate-term incremental challenges, and it comes at a very high price to HP stockholders.

We do not at all believe that HP should stand still. On the contrary, we think that the fast pace of change in the technology industry is one of the prime reasons that the distractions of this merger will be harmful to HP. HP is a strong company with many assets. We would prefer HP to focus on what it does well, and to change and grow organically, with targeted tactical acquisitions, which has been the strategy of most successful technology companies.

HP S BUSINESS PORTFOLIO WILL BE WORSE.

Based on estimated calendar year 2001 revenues, the percentage of HP s revenues derived from its profitable imaging and printing business would fall from 43% before the proposed merger to 25% if the proposed merger is consummated, while the percentage of revenues derived from the unprofitable PC business would increase from 20% to 30%. Of Compaq s $33.0 billion in total estimated sales for 2001, $14.6 billion is expected to come from PCs. Since 1998 Compaq has had consistently lower margins and returns than HP.

The imaging and printing segment has at least 10% normalized operating profit margins and the market is projected to grow at over 10% per year, while the PC segment is currently unprofitable and that market is expected to shrink for the next several years, and then to grow at less than half the rate of the imaging and printing market.

HP S STRATEGIC POSITION WILL NOT MATERIALLY IMPROVE.

While HP clearly has strategic challenges to address, the proposed merger does not resolve them it compounds them. The strategic impact of the proposed merger on HP s primary businesses is discussed below.

PCs/Access

PC industry fundamentals are unattractive. On an industry-wide basis, the number of PCs sold is expected to decline by 2.4% in 2001 as compared to 2000, and the revenues derived from such sales are expected to decline by 13.9%. IDC forecasts that, on an industry-wide basis, PC revenues will decline by 6% per year through 2003.

Neither company has a profitable PC business model. HP has been unable to migrate to a direct distribution model and thereby become more cost competitive with industry leader Dell currently only approximately 3% of HP s PC sales are via direct distribution. HP s PC business is estimated to lose $365 million in operating profit in calendar 2001 on revenues of $8.8 billion. Like HP s PC business, Compaq s PC business is expected to incur significant losses estimated to be $704 million on revenues of $14.6 billion in 2001. Compaq also has been unable to successfully transition to a direct distribution model. It has made some progress in the United States and almost none in the rest of the world currently analysts estimate only approximately 20% to 30% of its sales are direct sales. Analysts expect it will take several years for Compaq to become economically competitive with Dell.

Ms. Fiorina has said that this market has low barriers to entry and intensive price competition. **The combination of two unprofitable businesses, in an increasingly competitive market, that individually have made little progress in developing a direct distribution model, is unlikely to become a source of profit in a combined company.**

Enterprise

Compaq s enterprise business does not materially improve HP s strategic position in the enterprise market.

Compaq s market share is primarily in the low end of the market, where margins are lower and under increasing pressure from Dell. IDC defines entry level servers as servers with price points less than $100,000. Entry-level servers accounted for $7.6 billion (76%) of Compaq s $9.9 billion in 2000 server revenues. Average selling prices of entry-level servers have declined 52% from the end of 1997 to the third quarter of 2001. **Ms. Fiorina has said that this market also has low barriers to entry and intensive price competition. Compaq management has acknowledged increasing commoditization going forward.**

It is not necessary to have the leading position in entry-level servers to succeed in the attractive mid-range and high-end server markets. Compaq has a leading position in entry-level Windows servers with approximately $4.3 billion in sales, but such a position is not necessary to succeed in the attractive mid-range and high-end server markets. IBM, the current market leader in the profitable mid-range and high-end segments, had only $1.8 billion in entry-level Windows server sales in 2000. In comparison, HP had $1.3 billion in such sales in 2000.

Compaq s mid-range business would do little to improve HP s mid-range position, and the mid-range business Compaq contributes is likely to erode. During the first three quarters of 2001, HP held the number two position in the mid-range market with a 24.2% market share. Compaq held the number four position with a 6.9% market share. The combination of the two businesses would give the combined company a 31.1% market share. The combined company would still be behind segment leader IBM. Furthermore, that position would not be strong. Compaq and HP s primary mid-range offerings are both Unix solutions (Compaq s Tru64 Unix accounted for 66% of its mid-range server sales during the first three quarters of 2001, while HP s HP-UX Unix accounted for 97% of its mid-range server sales during this time). Industry participants widely acknowledge that because of the relative market positions of these two products (mid-range HP-UX servers had a 30.9% mid-range market share during the first three quarters of 2001, while mid-range Tru64 Unix servers had only a 7.7% market share during this time) that HP-UX not Tru64 Unix would be the surviving Unix operating system if the proposed merger were to occur. Analysts expect that Tru64 customers would be transitioned post-merger to HP-UX. In light of the significant switching costs associated with platform migration, many customers will consider alternative competitive offerings.

Compaq s higher-end offerings do not materially improve HP s strategic position or provide a platform for growth. The high-end segment is relatively small for both HP and Compaq. In 2000, HP and Compaq had $680 million and $935 million, respectively, in high-end server sales. During the first three quarters of 2001, HP had a 6.7% market share. While the addition of Compaq s 9.1% market share would bring the combined company up to a 15.9% market share, it would still be well behind segment leader IBM s 42.7% share. Compaq s high-end business is well-established with a limited number of customers, but is not likely to have a widely expanding customer base.

Portions of Compaq s storage business are attractive, but relatively small. They do not justify taking the risks of the proposed merger. In 2000, Compaq had $5.6 billion in storage revenue and shared the leading position with EMC with 17.6% market share. The overall storage market in 2000 was $33.9 billion and is projected to grow to $53.3 billion in 2004, a compound annual growth rate of 12.0%. Growth is being driven primarily by the storage area network (SAN) and network attached storage (NAS) segments, which are projected to grow from $4.4 billion and $2.0 billion in 2000, respectively, to $18.9 billion and $14.7 billion, respectively, in 2004, compound annual growth rates of 43.7% and 65.0%, respectively. In 2000, only $855 million, or 15.4%, of Compaq s storage revenues were in the attractive SAN and NAS segments of the markets where Compaq had 13.1% and 1.9% market shares, respectively. **Compaq s SAN and NAS storage revenues were only 2.0% of Compaq s revenues in 2000.** Management has stated that HP on its own is strong in the high-end storage segment and has a good position in emerging markets.

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Imaging and Printing

The merger does not add to HP s current leadership position in the attractive imaging and printing markets. Management implies that the only way to improve the performance of HP s other business and thereby reduce the cash drain on its imaging and printing businesses is to merge with Compaq. Management de-emphasizes or ignores the following key facts:

- the integration may fail;
- even if successful, the integration will be very difficult and will take years to complete; and
- management focus and financial investment are likely to suffer during the integration.

However, in this fast moving market, HP cannot afford to wait or to take the substantial risk that the integration will fail. Diversion of management attention during the integration process and under-investment in imaging and printing could have a significant adverse impact on HP s leadership position in the future.

Management focus on the imaging and printing business is likely to suffer as a result of the proposed merger. The integration of HP and Compaq will take a significant amount of management s time and attention. The loss of focus is likely to have an adverse impact on HP s imaging and printing business. Gartner Dataquest believes HP may become too preoccupied to dedicate the funding and executive-level attention required to maintain leadership in the printer industry. IDC concludes, In the short term, the risk that the new HP will lose printer share during the sales integration process is very real and may well offset the small gain in volume from Compaq printer shipments taken from Lexmark.

HP s ability to invest in its imaging and printing business is likely to suffer as a result of the proposed merger. **Compaq s PC business is estimated to lose $704 million in 2001** and its other businesses are expected to produce a profit of approximately $936 million in 2001 (approximately 1.3x the loss generated by the PC business). In contrast, HP s PC business is estimated to lose $365 million in calendar 2001 and its other businesses are expected to produce a profit of approximately $2.2 billion in 2001 (which is equal to approximately 6.0x the loss generated by the PC business). As a result of the proposed merger, the profits from HP s imaging and printing business are more likely to be used to subsidize the combined PC business for several years. Management predicts a profitability turnaround, but this is far from certain, and in any event will take years to accomplish. IDC concludes, In the longer term, if HP increases its use of the imaging and printing profits it runs the risk that in a few years its products in the imaging and printing space will be weakened relative to those of competitors. Gartner Dataquest believes that the proposed merger of HP and Compaq will likely not allow for the huge investments needed to be successful in high-speed commercial printing.

Services

Compaq s service business does little to increase HP s consulting and outsourcing capabilities. High-growth consulting and outsourcing capabilities are what HP needs to compete with IBM in selling high-value-add, end-to-end customer solutions. Management recognized this in its public statements regarding its attempted acquisition of the consulting division of PricewaterhouseCoopers. Compaq s service business is very similar to HP s service business. They are both focused on the lower-growth and lower-margin hardware support and maintenance segments. The proposed merger would not provide any meaningful assistance to HP in increasing its capabilities in high-end services. It is estimated that at least half of Compaq s support service revenue comes from DEC Alpha customers who are more likely to select competitive platform alternatives as the combined company rationalizes platforms. An erosion of the combined company s enterprise installed based would likely result in an erosion of its service revenue.

THE INTEGRATION RISK OF THE PROPOSED MERGER IS SUBSTANTIAL.

The statistical odds of success are not favorable for the proposed merger. It is widely acknowledged that the integration risk in the proposed merger is substantial. HP management described the transaction challenges as a massive integration effort . . . in the midst of reinvention . . . combining cultures. There is a

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remarkable body of evidence, ranging from academic studies to Wall Street analysis, indicating that three out of four large merger transactions fail to achieve their stated goals, and that the success rate for large technology transactions is even lower. There is no example of a large merger in computing which has been successful. HP and Compaq s own history (DEC, Tandem, Apollo and VeriFone) is no exception.

Revenue losses are likely to be substantially greater than HP forecasts of 5% . We believe the case presented by management is optimistic. Compaq s own experience with DEC yielded revenues 13% below analyst projections for 1999. For the proposed merger, analysts have estimated that revenue losses as a percentage of sales could be as high as 15% for the combined company in 2002 and up to 17% for the combined company in 2003. Additionally, The Parthenon Group estimates revenue losses of 10% for the combined company in 2003.

Revenue losses are likely to be concentrated in PCs and the enterprise segment, but not exclusively. In PCs, the combined company would have 60-70% market share of the retail consumer PC market. This share is likely to be unsustainable as both retailers and consumers encourage competition in order to limit supplier power and facilitate greater choice. In the enterprise segment, the elimination of overlapping technology and software platforms, as well as sales personnel, will likely prompt many existing customers to consider competitive offerings. (In a recent survey of DEC Alpha server customers conducted by UBS Warburg, LLC, fully 90% of the respondents said if the combined company tried to migrate Alpha customers to HP-UX, it would cause the customers to consider other vendors.) Revenue loss in the enterprise segment will translate into revenue loss in services as well, as the service business is principally in support of enterprise customers. Management s projection of no revenue loss in services seems implausible.

THE FINANCIAL IMPACT ON HP STOCKHOLDERS HAS BEEN AND WILL BE NEGATIVE.

From the day prior to the announcement of the proposed merger through the day prior to our announcement of our opposition, HP stockholders lost $12.3 billion in value. On the day that we made public our opposition to the proposed merger, HP stockholders gained $5.7 billion in value.

The equity market has twice made resoundingly clear its view that

this combination destroys value for HP stockholders.

	HP	CPQ	S&P 500	Index
9/3/2001	100	100	100	100
	82	90	100	101
	78	84	100	100
	76	84	98	97
	78	86	96	95
9/10/2001	77	84	96	96
	69	71	92	93
	70	69	91	92
	66	66	90	92
	62	64	87	88
	64	65	85	84
9/24/2001	69	69	89	90
	69	72	89	90
	69	68	89	87
	70	69	90	85
	69	67	92	87
	67	67	92	86
	66	66	93	87
	69	70	95	92
	69	72	94	94
10/5/2001	71	71	95	95
	73	73	94	96
	72	73	93	94
	73	77	95	94
	78	80	97	99

	79	80	96	99
	78	79	96	99
	80	82	97	100
	78	79	95	98
10/18/2001	76	77	94	97
	79	79	95	98
	79	78	96	101
	77	76	96	101
	78	79	96	103
	78	79	97	107
	77	77	97	107
	75	74	95	104
10/30/2001	73	73	93	102
	73	71	93	103
	75	74	96	106
	73	74	96	107
	73	73	97	110
	85	69	99	113
	83	65	98	113
	79	65	99	114
	82	63	99	114
11/12/2001	83	62	99	114
	87	71	100	117
	95	81	101	116
	95	87	101	117
	93	83	100	116
	93	84	102	118
	90	78	101	117
	88	78	100	114
11/23/2001	90	79	101	116
	91	80	102	118
	87	77	101	118
	87	73	100	115
	92	78	101	118
	95	82	101	120
	93	82	100	118
	97	87	101	121
12/5/2001	100	94	103	127
	101	90	103	126
	101	92	102	124
	99	79	101	123
	95	77	100	124
	94	79	100	125
	91	76	99	120
	90	77	99	120
12/17/2001	89	77	100	121
	88	74	101	122
	89	73	101	123
	89	74	101	121
	90	80	101	120
	89	78	101	119
	90	79	101	120
	90	80	102	122
12/28/2001	90	80	102	121
	88	79	101	120
	93			