HOUSE

HEWLETT PACKARD

Hewlett-Packard

1989 Annual Report

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Corporate Profile

Hewlett-Packard Company designs, manufactures and services electronic products and systems for measurement and computation. HP's basic business purpose is to provide the capabilities and support needed to help customers worldwide improve their personal and business effectiveness.

Financial Highlights

For the years ended October 31 Dollars in millions except per share amounts	1989	1988	Increase
Total orders	$12,160	$10,070	21%
Net revenue	$11,899	$ 9,831	21%
Earnings from operations	$ 1,212	$ 1,084	12%
Net earnings	$ 829	$ 816	2%
Net earnings per share	$ 3.52	$ 3.36	5%
Return on equity	16.6%	17.1%	
At year-end:			
Shares outstanding (in millions)	238	234	
Employees	95,000	87,000	

We're pleased to report that our 50th year was one of very strong growth for HP. After reaching our 1988 order goal of $10 billion, we achieved order growth of 21 percent in 1989 that sent us just over the $12 billion mark. This is the second consecutive year in which our orders have grown at a rate of 20 percent or more.

Net revenue growth of 21 percent matched our order growth, with net revenue totaling $11.9 billion. U.S. net revenue rose 17 percent. Net revenue from outside the U.S. grew 25 percent and represents 53 percent of our sales, slightly more than last year. Operating profit and net earnings, however, did not keep pace with the increase in net revenue. Operating profit was up 12 percent while net earnings grew only 2 percent to $829 million, or $3.52 per share.

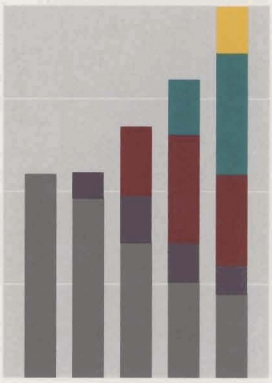
Factors affecting net earnings

Our operating profit was under pressure during the year because of the ongoing changes in our product and sales channel mix which increased trade discounts and our cost of sales as a percentage of net revenue. We have made some progress in balancing these effects by consolidating and improving our manufacturing activities, and by slowing the growth of our marketing, selling and administrative expenses during the year. Our actions to reduce expense growth included placing strict controls on external hiring in the second half of the year. To fill job openings, we began moving people within the company and, as a result, we had no growth in employment during the fourth quarter and ended the year with 95,000 people worldwide. We plan to continue these efforts to control expense growth in 1990 to help us achieve a more satisfactory level of operating profit.

Another significant factor which caused our low growth in net earnings this year was our acquisition of Apollo Computer Inc. for $500 million in May. The effects of acquiring Apollo reduced our net earnings this year by about 23 cents per share. Net earnings without the acquisition of Apollo would have been $3.75 per share, an increase of 12 percent over 1988. We believe, however, that the acquisition of Apollo has significantly strengthened our product line and our position in the fast-growing workstation market.

Also affecting our net earnings in 1989 was a decrease in interest income, coupled with an increase in interest expense. Our cash position was reduced, and some short-term debt was incurred, to fund the acquisition of Apollo in May and to meet working capital needs. Our cash position had already been lowered as a result of our share repurchase program. During 1988 and the first half of 1989 we purchased 32,351,000 shares of HP stock for an aggregate purchase price of $1.7 billion. Over

HP Product Orders
By year introduced



This graph illustrates the key role new products play in HP's growth. Each bar indicates the year's total product orders, with the top section of each bar showing orders for those products introduced in that year. More than half of 1989's orders were for products introduced in the past three years.

a 17-month period, this program reduced the total number of HP shares outstanding by 14 percent.

In addition, our fourth quarter earnings were affected by a charge of approximately $9 million to cover replacement, repair and cleanup costs related to the major earthquake that struck the San Francisco Bay Area on October 17. No further charges are expected, and there was no material loss of revenue.

Operational highlights

In late October of 1988, we announced a realignment of some of our computer product groups and the formation of a computer business organization reporting to Chief Operating Officer Dean Morton. The purpose of this change was to provide one general-management focal point for HP's broad-based computer business. The formation of this group already has had a favorable effect on the performance of our computer business.

Our Medical Products Group had two major product introductions this year: a new clinical information system and a cardiovascular imaging product. The patient monitoring systems announced last year continued to sell very well, though we had some delays in manufacturing these systems during the first half of 1989. However, we were able to significantly increase our shipments later in the year.

Our analytical products business continues to show solid growth and good profit. We experienced strong demand for our products from the petrochemical, chemical, pharmaceutical and biotechnology industries.

During the year we introduced workstations based on the MS-DOS® operating system, making chemical analysis systems less expensive and easier to use.

Net revenue from the sale of electronic components grew 6 percent during the year, with a strong order growth rate in the first half and a slowing of demand in the second. We experienced good growth in sales of fiber-optic devices, and our components now are being designed into even more consumer products.

As was true last year, order growth for our test and measurement products was greatest outside the U.S. However, we were pleased that U.S. orders for these products were stronger in 1989 than in 1988. We also introduced many significant new products this year including families of low-cost, digitizing oscilloscopes and ruggedized, portable spectrum analyzers, a lightwave component analyzer and a system for testing local area networks. High demand for our new test-system products has strengthened HP's position in automated test equipment for integrated circuits and printed-circuit boards.

HP's support organization this year continued to introduce innovative products, which are described later in this report. While HP's internal computer operations were only minimally affected by the earthquake in the San Francisco Bay Area, some

David Packard
Chairman of the Board

John Young
President and
Chief Executive
Officer

of our customers were not as fortunate. For these people, HP provided free remote support and on-site damage assessment of earthquake-related problems. For example, through our response center in Atlanta, our support people were able to help the largest blood bank in San Francisco restore its inventory control system within a half-hour after its HP 3000 computer went down.

HP lists on European exchanges
In April of this year we listed HP stock on the exchanges in London, Paris, Frankfurt and Zurich. The listings support HP's commitment to the rapidly expanding European market. 1989 marked the 30th year of HP's operations in Europe.

HP sells South African subsidiary
In March we announced our decision to sell our South African sales subsidiary to Siltek Ltd., a South African manufacturer and distributor of computer products. Siltek has taken over all the assets and operations, as well as the marketing, distribution and servicing of HP products in South Africa. Our decision to leave South Africa was a difficult one that came only after long and careful consideration. Increasing political and economic uncertainties made it difficult for us to maintain our long-term commitments to our customers there. Leaving South Africa will make it more difficult for us to contribute to constructive change in that country although we have established a trust to continue to support several local programs to help black South Africans.

A decade of rapid change
The 1980s brought very rapid change to HP, both in terms of technology and in the increasing competition we're facing in global markets. The pages that follow describe some of the actions we've undertaken during the decade to strengthen our competitiveness.

Despite this rapid pace of change, two things remain constant and continue to serve us well. These are our people and our management style, something we call "The HP Way." We believe that trusting and respecting HP people is the best way to attract capable, innovative employees and to encourage their contributions and loyalty.

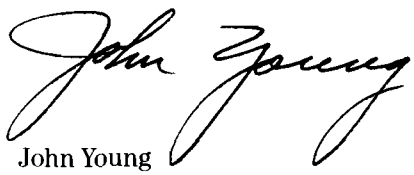
Coping with rapid change is never easy. During the 1980s, we've worked hard to increase our corporate flexibility. And to do this, we've asked for and received a lot of individual flexibility from our employees.

We believe the 1990s will be even more difficult. Markets will be more competitive and more global, and technology will change even more rapidly. In response to this demanding environment, we keep sharpening our competitive edge. We continue to invest heavily in research and development and this year formed a new research board of directors that includes many world-renowned scientists from outside HP. This board will advise us on an ongoing basis as we set our research agenda for the future.

We're also working to increase our flexibility to respond to market changes and changing customer needs. And we're improving our ability to commercialize technology quickly and to reap the financial rewards of doing so. All of these things will help us improve our profitability in this increasingly competitive environment.

The year ahead
Most economists now are suggesting an environment of slower growth in the year ahead, and we are preparing ourselves for this possibility. However, we have a strong product position that will help us capitalize on opportunities as they develop.

David Packard
Chairman of the Board



John Young
President and Chief Executive Officer

December 8, 1989

We at Hewlett-Packard have been working to sharpen our competitive edge. The pace of change has been quickening during the decade of the 1980s, and the barriers to the movement of technology and trade have been dissolving. The result is a rapidly changing economic landscape that presents many new opportunities for companies like HP.

The following pages describe some of the major, ongoing initiatives we've undertaken to heighten HP's ability to compete in global markets and to win. The benefits include not only the strengthening of our own company, but the ability to use what we've learned to help our customers meet the growing demands of this more competitive business environment.

For more than 30 years, HP has been meeting the challenges of doing business on several continents. We've learned that giving the appropriate information and computing resources to individuals and work groups is the best way to manage and tie together our worldwide business and to help our people be productive.

HP's operations are now run with the help of approximately 2,500 minicomputers and 85,000 personal computers, workstations and terminals linked into a worldwide communications network. These machines give direct access to key information to a majority of our 95,000 employees worldwide. Our companywide network carries the equivalent of eight million pages of information daily, about the same as the world's largest public data network.

In-house video teleconferencing facilities like those pictured here and a closed-circuit television network also help employees from different locations work together more easily. These electronic links help us capitalize on the special talents of our employees around the globe.

Today our customers are benefitting from the wealth of experience we've gained in developing and using distributed information systems to run our worldwide operations.

The Hertz Corporation speeds customers on their way faster with the help of a worldwide rental system that runs on a network of HP Precision Architecture computers. Computerworld magazine has ranked Hertz's information systems among the top 10 in the transportation industry.

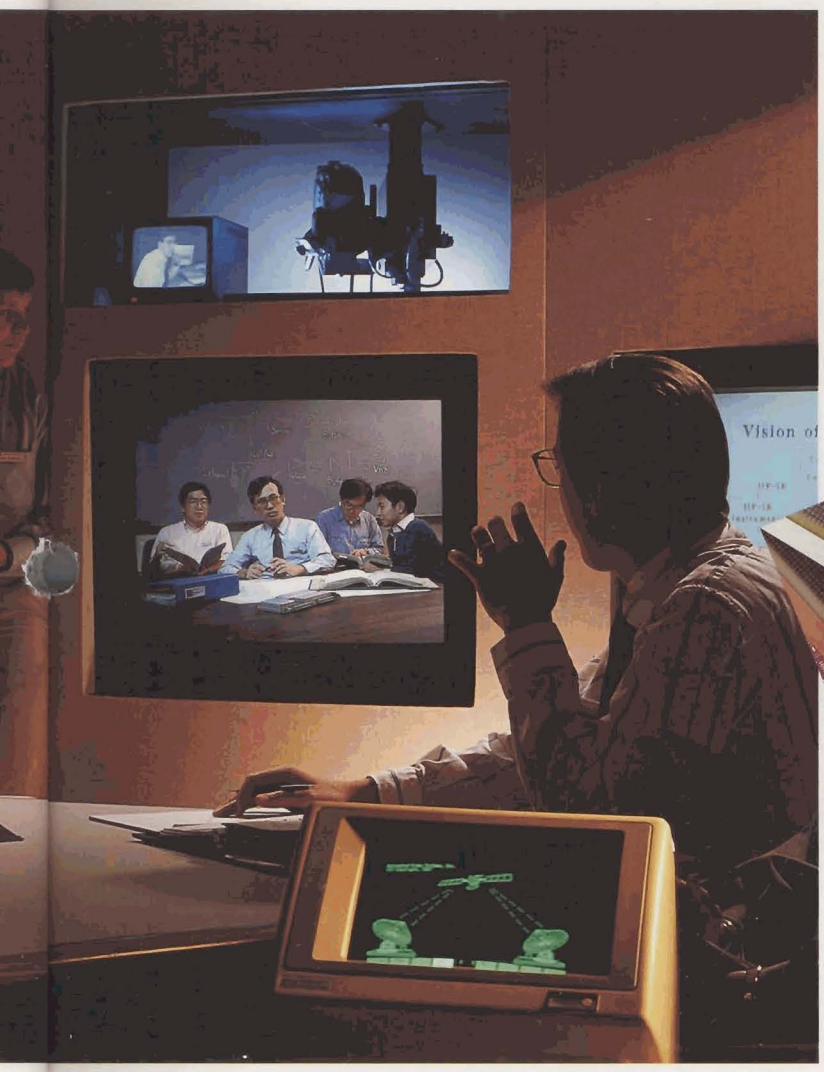
Palo Alto, California

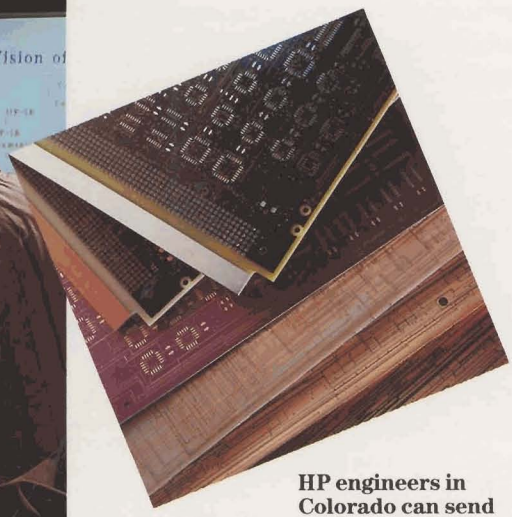
more than 1,600 personal computers at 26 member firms throughout the city, including computers made by other vendors.

Trading hundreds of millions of dollars each day, the Stock Exchange of Singapore relies on HP networking and support to link

HEWLETT PACKARD
Authorized Dealer

Through the HP News Network, HP dealers in 12 countries can get immediate access to news and information about products and their availability from an HP 3000 minicomputer in California. They also receive customer leads over the network from HP's Customer Information Center.

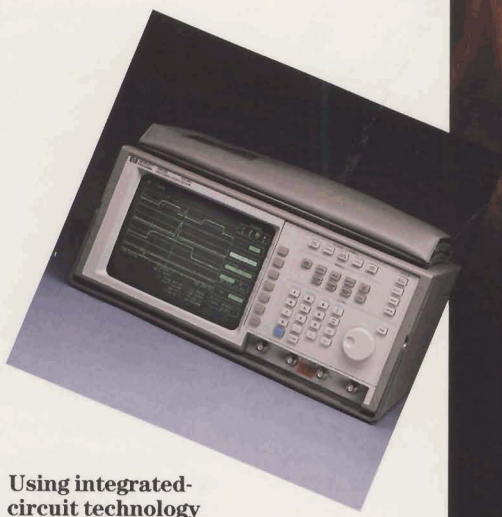




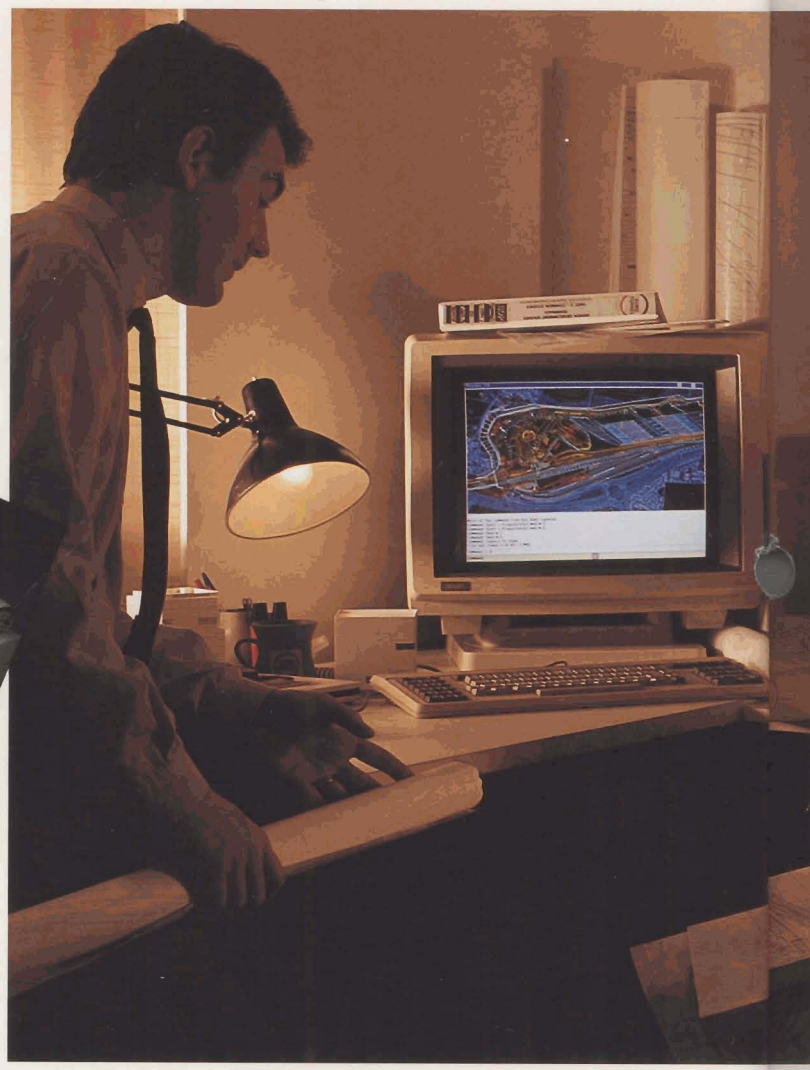
HP engineers in Colorado can send designs for new printed-circuit boards via an internal data network to an HP fabrication facility in Boeblingen, Germany and have prototypes back in seven days. Information is entered into the system only once, reducing the chances for error and speeding the production process.

HP relies heavily on information and communication systems to help us manage our global company and to enable our people to work together more effectively.

HP has significantly advanced the development of object-management technology in the HP NewWave software environment. American Airlines will use it to improve productivity by making it easier for people to combine information across different personal computer applications and to automate routine tasks.



Using integrated-circuit technology originally developed for HP Precision Architecture computers, HP now offers a digital oscilloscope with higher performance than comparable analog scopes, but at a lower price.



To remain at the leading edge of technology, HP continues to invest heavily in research and development. We are also reaching outside the company for new ideas and technologies.

Investing in New Technology and Products

New products are the lifeblood of our company; more than half of our revenue each year comes from products introduced in the past three years. HP invests approximately 10 percent of net revenue in research and development annually. HP Laboratories, the company's central research facility, is world renowned, and develops many new technologies that are further refined and commercialized by HP divisions around the world.

Because the needs of our customers are increasingly diverse and complex, we're also supplementing our efforts by acquiring products and technologies through equity investments, licensing agreements, and a variety of cooperative research activities. These initiatives help us bring products to market more quickly, while also managing our research and development costs.

In 1989 we acquired Apollo Computer Inc. whose industry-leading network computing technology helps people in different locations work together more effectively. This technology is being used by Building Design Partnership in designing and building the UK terminal at Folkestone, as pictured on this page, which will be part of the tunnel under the English Channel.

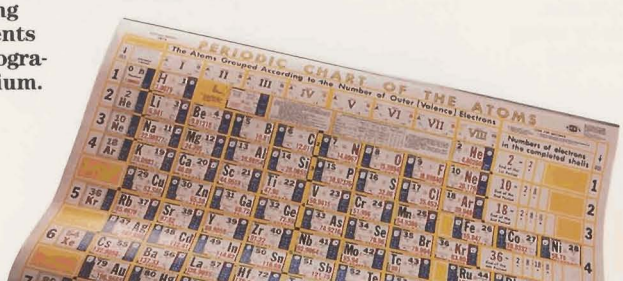
HP has established science centers in the U.S. and Europe to do joint research with leading universities, and will be opening a center in Japan next year. We're also collaborating on high-temperature superconductivity research with DuPont Company and Los Alamos National Laboratories.

London, England

HP has announced plans to license its reduced-instruction-set-computing (RISC) technology to Hitachi Ltd. and Samsung Electronics Co. Ltd., and will collaborate with them on the development and production of new workstations and microchip sets to expand HP's product line more quickly. HP will license Hitachi's bi-polar CMOS integrated-circuit technology for use in future HP products.

HP's new atomic-emission detector is the first analytical instrument capable of detecting all of the elements in gas chromatography except helium.

Because the instrument can screen for four elements simultaneously, it also performs chemical analyses more efficiently.



Developing Better Products Faster

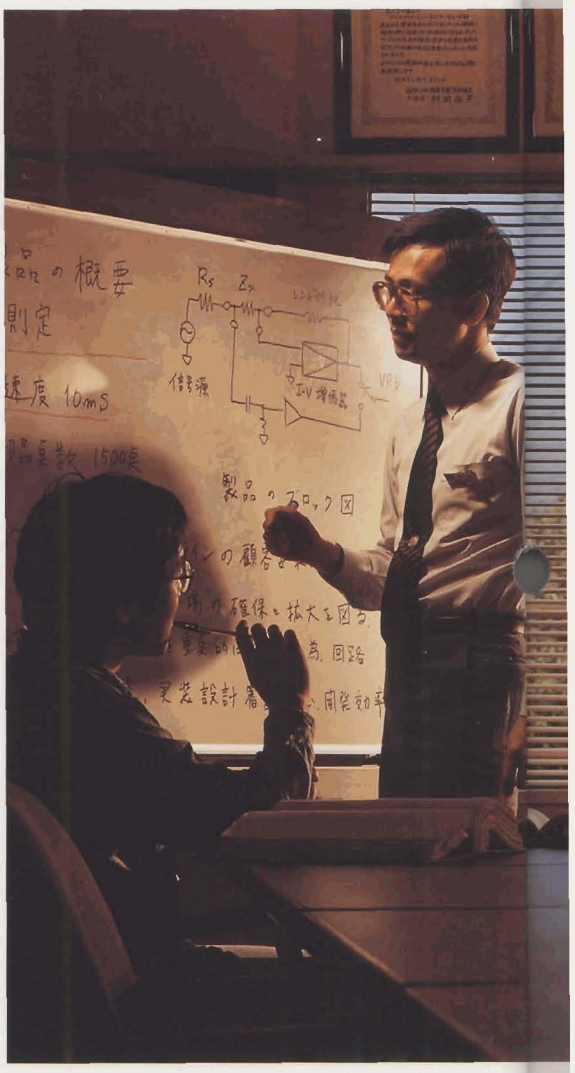
We've been working to reduce the time it takes us to bring new HP products to market by giving our engineers better design tools and by encouraging more teamwork among the research and development, manufacturing and marketing departments early in the development process.

HP engineers use networks of computer workstations that speed product design and allow many people to work together efficiently on the same project. Engineers also have access to a database of recommended parts available from qualified suppliers. These tools and early input from manufacturing engineers help us create new products that use fewer parts, are easier to manufacture, and can be made taking advantage of existing manufacturing equipment and processes. The benefits of this "designing for manufacturability" include not only reduced materials and manufacturing costs, but also higher product quality and reliability, and faster manufacturing rampup.

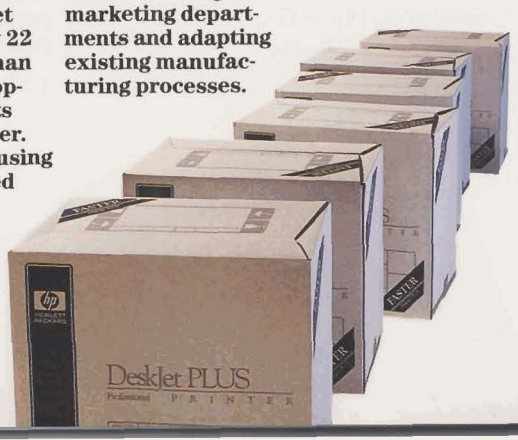
Faster time to market isn't our only goal. We also want our products to be accepted quickly in the marketplace. To accomplish this we're using market research more effectively to help us target new products to meet specific customer needs.

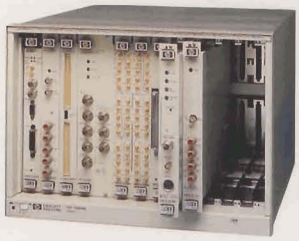
Hughes Aircraft has reduced the time it takes to manufacture its air traffic control workstations from 40 to 4 days using just-in-time manufacturing and a Hewlett-Packard-based paperless manufacturing system. Future models of these workstations will also be based on HP 9000 minicomputer technology.

Hachioji, Japan



HP's division in Vancouver, Washington introduced the HP DeskJet printer in only 22 months, less than half the development time of its previous printer. They did it by using computer-aided design tools, emphasizing close teamwork among the research and development, manufacturing and marketing departments and adapting existing manufacturing processes.



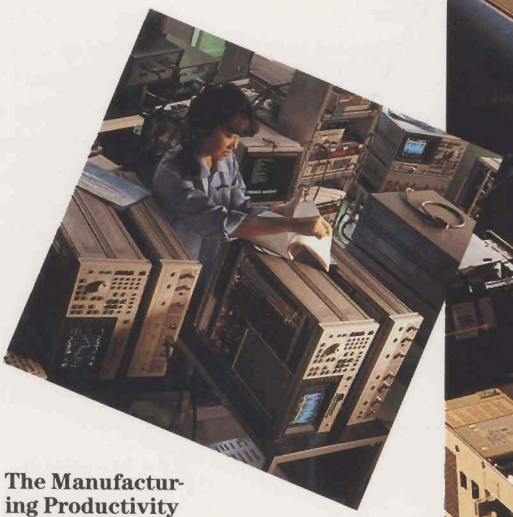


Because of HP's expertise in building and using complex test systems, we appreciate the problem of having to write software to communicate with different instruments in a test system. To solve it and reduce test development time, HP has introduced TMSL (the Test and Measurement Systems Language). TMSL has been opened to the industry as the basis of a new communications standard.

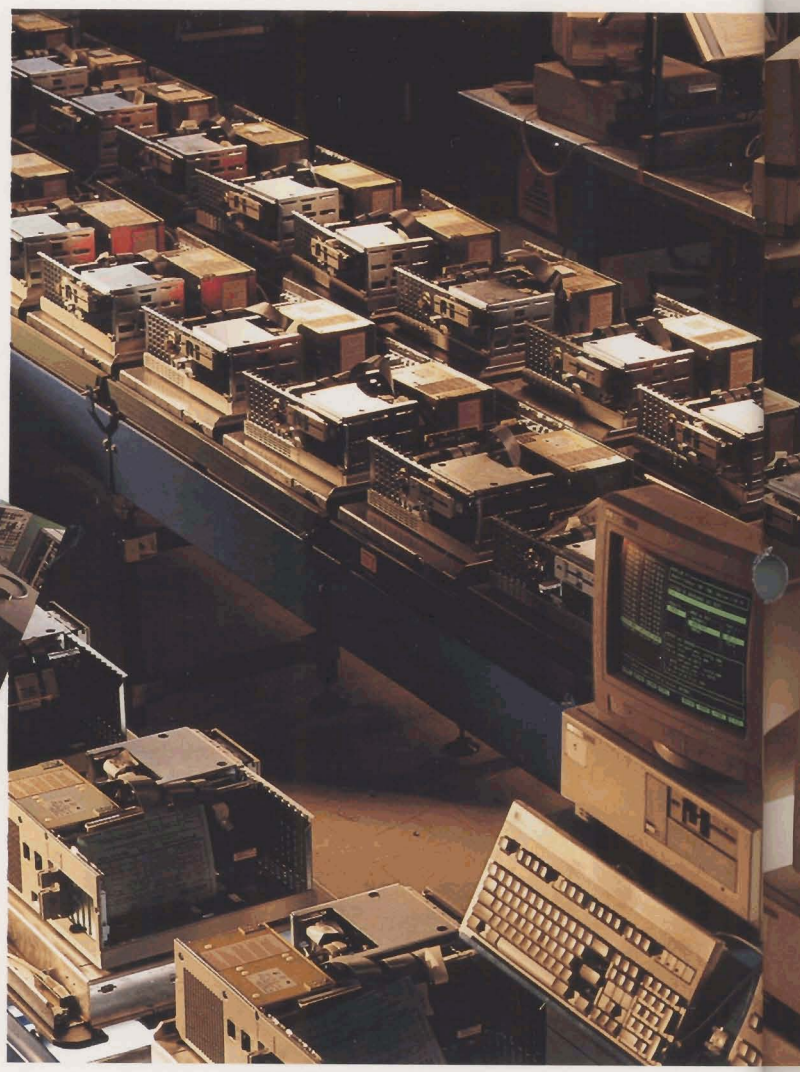
HP's new board-test system helps customers speed product development by reducing test development time. Our experience in surface-mount technology helped us design this system, which tests both complex digital and analog printed-circuit boards. This system is the first total test solution for surface-mount manufacturing of these boards.

The rapid pace of technological change gives a competitive edge to companies that bring new products to market quickly. HP is using advanced technology and teamwork to reduce product development time.

HP's computer-integrated-manufacturing facility in Singapore can change production machine settings automatically to produce 309 models and options of keyboards. Any process deviation can be identified immediately and corrected quickly, ensuring only high-quality keyboards are shipped.



The Manufacturing Productivity Network at the Yokogawa Hewlett-Packard (YHP) factory in Hachioji, Japan, links engineering and manufacturing data. The network has helped YHP to improve the efficiency of its manufacturing processes by 30 percent and reduce the time to market of new products by 20 percent. On the strength of these achievements, YHP won the 1988 Ishikawa Prize from the Japanese Union of Scientists and Engineers.



To enhance HP's competitiveness we're working to reduce manufacturing costs and increase both the quality and flexibility of our production processes. HP's factories are among the most rapidly changing parts of the company.

Achieving Excellence in Manufacturing

By carefully evaluating and improving our manufacturing processes, HP has been able to implement just-in-time (JIT) and computer-integrated manufacturing (CIM) in many facilities. Some HP factories can now make lot sizes as small as one cost-effectively, and all factories can react more quickly to improve quality and respond to changes in order patterns. We've established closer working relationships with our suppliers and have consolidated many key manufacturing processes to improve efficiency.

We've also increased the involvement of production workers in improving and troubleshooting production processes as well as in planning their activities. The levels of supervision in our factories have been decreased, and we've increased the spans of control of individual supervisors. Both productivity and teamwork have improved as a result of these changes, and manufacturing overhead has been reduced.

Despite our achievements, we know today's "best practices" will likely be the minimum acceptable to remain competitive by the mid-1990s. We remain committed to manufacturing excellence and expect that our factories will continue to be areas of rapid change.

Grenoble, France

Ferrari S.p.A. uses a special system designed by HP to test the advanced electronic systems of the new Ferrari 348 at its factory in Maranello, Italy. Based on HP 1000 minicomputers, the test system helps Ferrari produce quality cars by checking the integrity of electronic components and systems.

These tiny, telemicrorobotic tweezers were designed by the manufacturing research group at HP Laboratories. With a head about the size of a pencil tip, these tweezers will give HP manufacturing workers greater dexterity in assembling delicate microcircuits.

Increasing Marketing and Selling Effectiveness

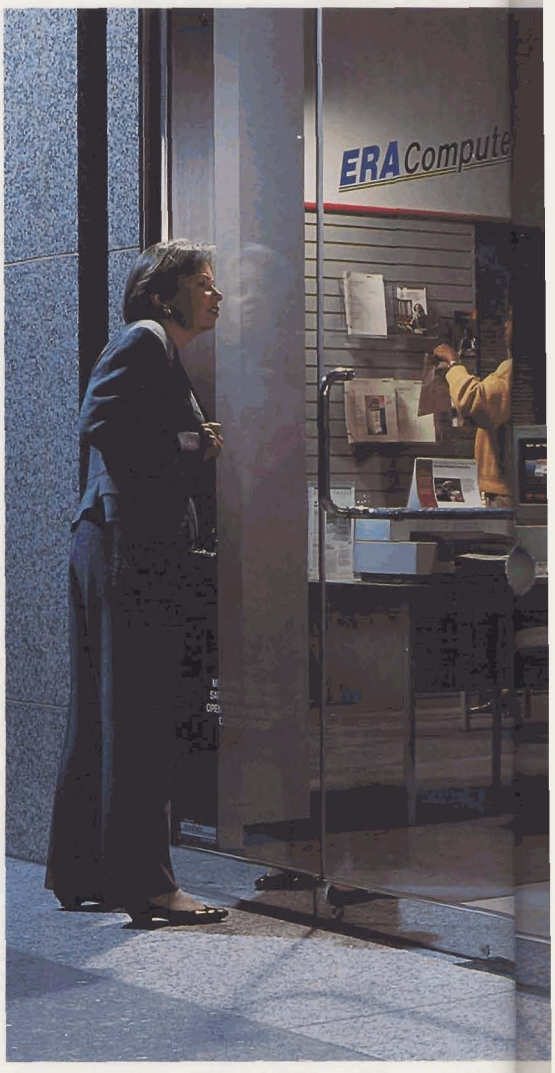
As HP has expanded into new markets, we've become more systematic about capturing customer feedback and managing it in a way that better supports our decision making. For example, more customer satisfaction surveys, focus group testing and competitive analysis help us better understand our growing customer base and diverse markets.

As in so many other areas, we're using information systems to help us market and sell more effectively. One worldwide database keeps track of our customers, what products they've bought and how they're using them. We can now contact customers quickly about product upgrades, improving both customer satisfaction and sales. And we're giving our sales people new software tools to help them manage leads more effectively and feed win/loss information back to marketing.

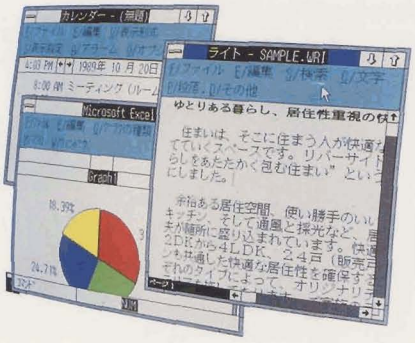
We've also increased the channels through which we sell our products and are working with additional companies in order to provide more complete solutions to customer needs and increase our access to global markets. And for customers who would rather lease than buy, HP offers leases on new or remanufactured equipment. Our marketing database helps us measure the effectiveness of these different distribution channels and marketing programs.

HP has formed a joint venture with Telecom Australia to provide fully integrated computing and telecommunications systems to Australian customers. Relationships such as this give HP access to broader markets and enable us to provide a wider range of products and support services.

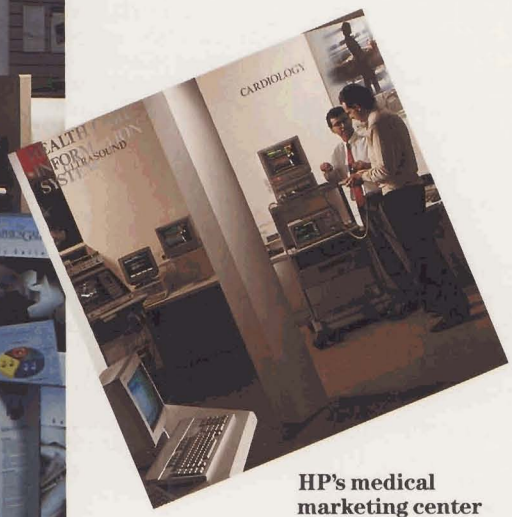
San Francisco, California



HP's Asian Integrated Business System takes product localization to a high level by supporting two or more languages concurrently for use by multinational companies doing business, for example, in both Japanese and English. The system is one of the first to enable applications in Japanese, Chinese and Korean, including networking and electronic mail software, to be shared among minicomputers, personal computers, terminals and printers.

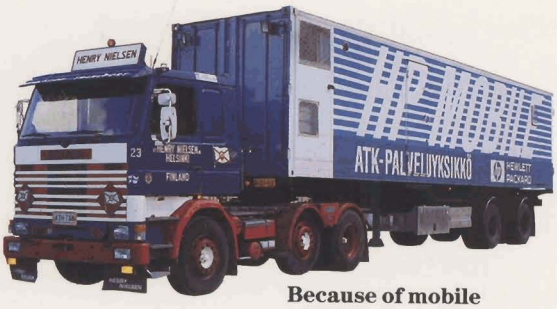


HP's Customer Information Center in Cupertino, California provides U.S. customers with one toll-free number to get information about any of HP's products and services. Callers receive information quickly, and qualified leads are passed on to the appropriate HP salesperson. There are also local centers in Europe and the Far East.



HP's medical marketing center in Boeblingen, Germany provides a single location where customers from across Europe can try all of HP's medical products. Patient responses can be simulated electronically, allowing medical personnel to test the equipment in mock-emergency situations.

We're listening to our customers and using their input to shape new product and distribution strategies. One result is an increasing percentage of sales through channels such as dealers.



Because of mobile computer rooms like this one in Finland, subscribers to HP's Disaster Recovery Program can have their information systems up and running within hours following a fire or other disaster.

In the healthcare field, uninterrupted patient care is a critical concern. Seven HP Medical Response Centers worldwide provide full-time specialists, HP equipment and other resources exclusively dedicated to supporting our medical customers and products. HP is the only company to offer this level of customer support in medical electronics.

For HP customers worldwide, support is as close as the phone 24 hours a day. HP's premiere support organization is an important factor in satisfying our customers and in making them more competitive.

Making Outstanding Support a Competitive Advantage

HP has worked to build a worldwide customer support operation that does much more than maintain and repair equipment. HP support also helps customers choose and configure the right systems, with HP providing planning and installation assistance and on-site training.

With these services and innovative additions such as the operation and management of multivendor networks, software that predicts system failures before they happen, and mobile disaster-recovery facilities, we're working to help our customers achieve the competitive advantage our products can provide. HP has also been a leader in taking responsibility for the planning, implementation and maintenance of data networks connecting computers from different vendors.

HP provides local support in each country where we operate, helping us meet the special needs of our customers with global operations. Our response centers in California, Georgia, Australia, Singapore and the UK enable us to provide support to our customers 24 hours a day, 365 days a year. These centers also act as a focal point for information on how to resolve hardware, software and multivendor network problems, enabling our support engineers to take advantage of the work of their HP colleagues around the world.

Mountain View, California

In order to support HP customers better, we've made it possible to buy products like these from HP-authorized dealers or by phone from HP's Direct Marketing Division, which provides same day shipping without a handling charge for all product orders received by 4 p.m. Similar ordering services are available through HP distribution centers in Europe, Canada and the Far East.

HP Laser RX/MPE enables users of the MPE operating system to monitor and troubleshoot their computer's performance easily during system operation.

HP support services available on a CD-ROM (compact disk, read-only memory) have been expanded to make it easier to maintain computer systems. HP LaserRELEASE quickly installs and updates software on HP 3000 minicomputers, and

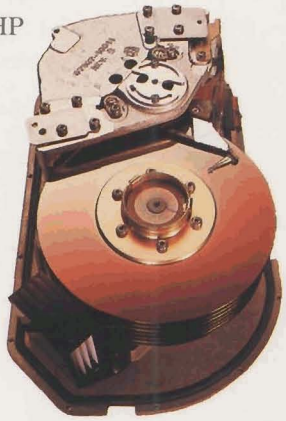
Using Quality to Increase Customer Satisfaction

Customers define quality, and their expectations are rising. In today's multivendor environment, people are presented with more choices, and companies must work harder to earn their loyalty. At HP we're using the principles of total quality control, or TQC, to improve the quality of our products and of everything we do.

With TQC, every activity is viewed as a process that can be continually measured and improved. Customers are whoever receives a product or service, be they external customers or HP employees. And doing things right the first time is the goal.

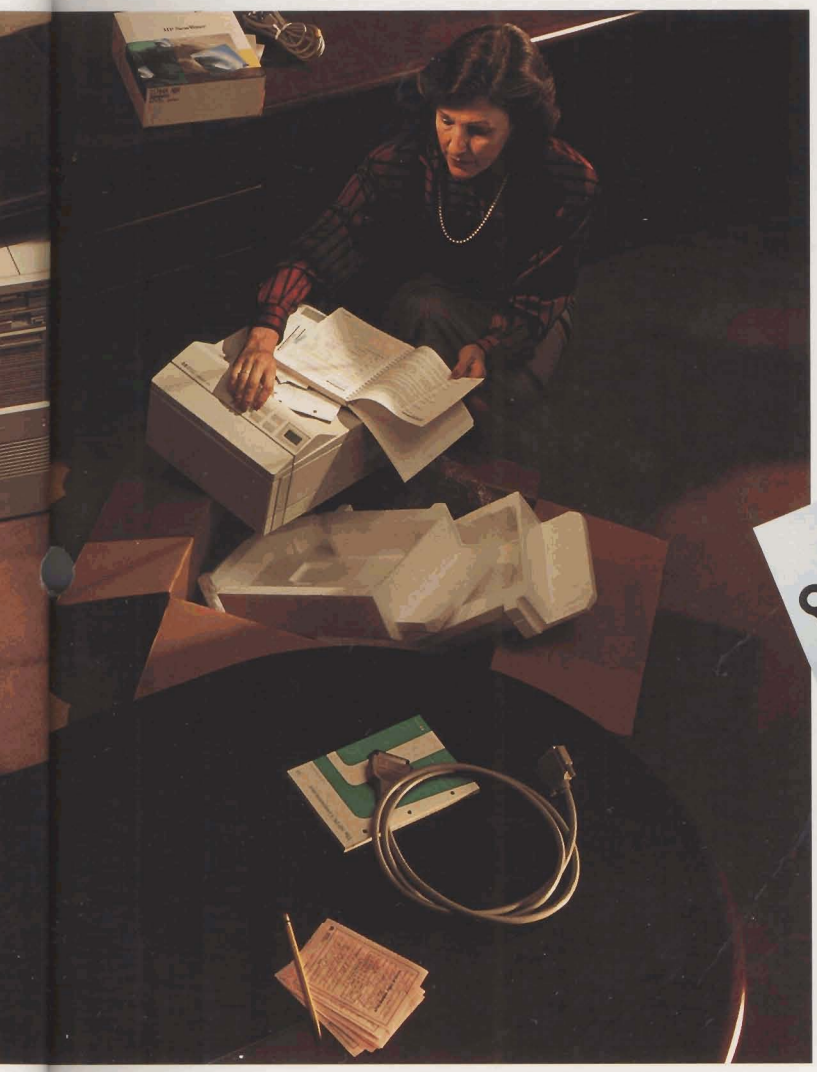
In manufacturing, we've been working on process improvements that reduce the need for rework and inspection. To make sure we start with quality parts, we've established close working relationships with our suppliers that have helped us to reduce the cost of incoming inspection and to improve final product quality and reliability. In marketing and administration, we're using TQC and customer feedback to improve our products and services and make it easier for people to do business with HP. For example, we've established consolidation centers to help us provide simultaneous, on-time delivery of all the products a customer orders as part of an HP system, regardless of where in the world they come from.

Using a computer-integrated-manufacturing solution from HP, Motorola Inc.'s pager facility in Boynton Beach, Florida has reduced the time from order entry to product shipment by 85 percent, and cut the defect rate by half. In 1988, Motorola won the U.S.'s prestigious Malcolm Baldrige National Quality Award.



HP's 8-inch disk drives made in Boise, Idaho have now achieved an unprecedented mean-time-between-failure rate of more than 72,000 hours based on actual customer data from more than 75,000 machines.

Based on a TQC study of its marketing processes, HP's Test and Measurement group determined the needs of its low-volume customers weren't being met adequately because HP's sales representatives aren't able to call on them frequently. The group has begun direct-marketing campaigns for many of its instruments with good success.



By involving all employees in its quality program, the Barcelona Peripherals Operation in Spain has achieved a 63 percent increase in on-time shipments in one year and a record of only one shipment error in 17 months.

All of HP's initiatives to improve our competitiveness are aimed at improving customer satisfaction. When customers open an HP box, they expect superb quality.

The table below is evidence of Hewlett-Packard's commitment to hiring and developing minorities and women. Studies indicate these groups will account for a growing portion of the work force in the future, and HP is positioning itself to take full advantage of the best available candidates. The company actively supports minority engineering programs at selected universities with philanthropic grants, loaned professors and a student summer internship program. While we've made progress in attaining Affirmative Action goals, we recognize our future success depends on our ability to continue developing qualified women and minorities for all levels of management.

In 1989, half the company's U.S. managers completed a training program developed last year on managing a diverse work force. The training provides managers with increased awareness of the advantages of a multicultural work force and gives them specific skills to improve team building and help employees develop to their full potential.

During 1989, the company made grants of cash and its own products totaling $70 million. Of that amount, $59 million went to education, mostly to university programs in engineering, computer science and business. We believe it's important to support programs that better prepare students for higher education and encourage their enthusiasm for education, especially in the areas of math and science. This year we increased our support of primary and secondary education in the U.S. and Europe. We also contributed $7 million to health and human service agencies, a significant increase from prior years. Of that amount, nearly $4 million went to United Way under the company's policy of matching employee contributions dollar-for-dollar.

Protecting the Environment

Because of our concern about the environment, we've developed programs to minimize the amount of solid and hazardous waste resulting from our manufacturing processes. In recent years, while experiencing continuing growth in our operations, the company has reduced its production of hazardous waste by an average of 10 percent per year. The benefits realized from these waste minimization programs include better protection of our employees and communities, a reduction in the potential for accidents, and cost savings on raw materials purchases, operating and disposal costs. A booklet with details of the program entitled "Hazardous Waste Minimization – 1989" is available from HP's Public Relations Department.

	Total Number	Minority		Female	
		Total	Percent	Total	Percent
Managers/Supervisors					
1984	8,680	926	10.7	2,187	25.2
1989	9,668	1,100	11.4	2,543	26.3
Professionals					
1984	17,429	2,226	12.8	4,949	28.4
1989	22,733	3,618	15.9	6,977	30.7
Technicians					
1984	5,719	993	17.4	872	15.2
1989	5,757	1,118	19.4	875	15.2
Skilled/Semi-skilled					
1984	15,519	4,446	28.6	8,264	53.3
1989	10,716	3,241	30.2	5,615	52.4
Percentage of HP Work Force			19.4		40.8

Financial Statements

Hewlett-Packard Company and Subsidiaries

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Statement of Management Responsibility

Hewlett-Packard Company and Subsidiaries

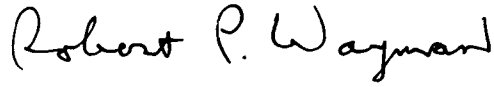
The company's management is responsible for the preparation, integrity and objectivity of the consolidated financial statements and other financial information presented in this report. The accompanying financial statements have been prepared in conformity with generally accepted accounting principles and reflect the effects of certain estimates and judgments made by management.

The company's management maintains an effective system of internal control that is designed to provide reasonable assurance that assets are safeguarded and transactions are properly recorded and executed in accordance with management's authorization. The system is continuously monitored by direct management review and by internal auditors who conduct an extensive program of audits throughout the company. The company selects and trains qualified people who are provided with and expected to adhere to the company's standards of business conduct. These standards which set forth the highest principles of business ethics and conduct are a key element of the company's control system.

The company's consolidated financial statements have been audited by Price Waterhouse, independent accountants. Their audits were conducted in accordance with generally accepted auditing standards, and included a review of financial controls and tests of accounting records and procedures as they considered necessary in the circumstances.

The Audit Committee of the Board of Directors, which consists of four outside directors, meets regularly with management, the internal auditors and the independent accountants to review accounting, reporting, auditing and internal control matters. The committee has direct and private access to both internal and external auditors.

John Young
President and
Chief Executive Officer



Robert P. Wayman
Senior Vice President and
Chief Financial Officer

Report of Independent Accountants

Hewlett-Packard Company and Subsidiaries

To the Shareholders and Board of Directors of Hewlett-Packard Company

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of earnings, of shareholders' equity and of cash flows present fairly, in all material respects, the financial position of Hewlett-Packard Company and its subsidiaries at October 31, 1989 and 1988, and the results of their operations and their cash flows for each of the three years in the period ended October 31, 1989, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

San Francisco, California
November 20, 1989

Consolidated Statement of Earnings

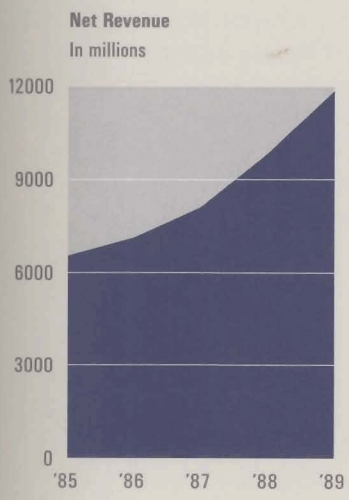
Hewlett-Packard Company and Subsidiaries

For the years ended October 31 In millions except per share amounts	1989	1988	1987
Net revenue:			
Equipment	$ 9,404	$7,709	$6,315
Services	2,495	2,122	1,775
	11,899	9,831	8,090
Costs and expenses:			
Cost of equipment sold	4,513	3,494	2,763
Cost of services	1,578	1,338	1,104
Research and development	1,269	1,056	930
Selling, general and administrative	3,327	2,859	2,388
	10,687	8,747	7,185
Earnings from operations	1,212	1,084	905
Interest income and other income (expense)	65	135	142
Interest expense	126	77	85
Earnings before taxes	1,151	1,142	962
Provision for taxes	322	326	318
Net earnings	$ 829	$ 816	$ 644
Net earnings per share	$ 3.52	$ 3.36	$ 2.50

The accompanying notes are an integral part of these financial statements.

Financial Review

Hewlett-Packard Company and Subsidiaries
Unaudited

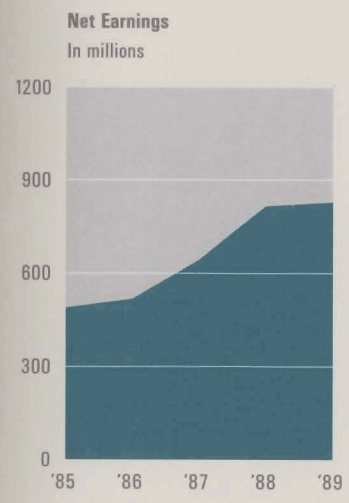


Results of Operations

In 1989, a challenging year for many companies within the electronics industry, HP's business continued to expand as the company reported strong growth in many of its product areas. This growth was primarily driven by favorable market acceptance of HP's new product offerings and continued success of many of the company's established product lines. Although the company reported a strong increase in net revenue for the year, operating profit and net earnings grew at a slower pace.

A significant factor in HP's overall performance in 1989 was the acquisition of Apollo Computer Inc. in May. Apollo designs, manufactures, markets and services network-based workstation and open computing products. The impact of the acquisition reduced HP's net earnings by 23 cents per share in 1989. Aside from the anticipated, adverse short-term financial effects, the integration of Apollo's operations, products and personnel into HP's workstation program is proceeding well and according to plan. Unless otherwise indicated, all 1989 amounts discussed below include the effects of the Apollo acquisition and five months of its operating results.

HP's orders were $12.2 billion in 1989, an increase of 21 percent over 1988. Net revenue also grew 21 percent to $11.9 billion after a 22 percent increase in 1988, while earnings from operations were up 12 percent to $1.2 billion compared to an increase of 20 percent in 1988. Net earnings rose 2 percent to $829 million following an increase of 27 percent in the prior year.

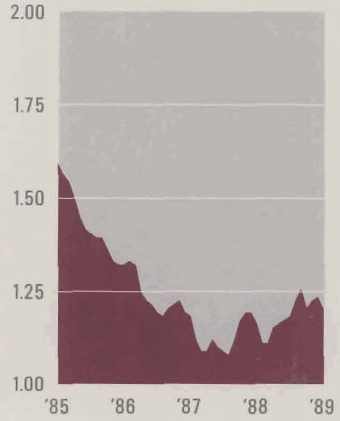


The company's net revenue growth in 1989 was strong both in the U.S. and internationally. While there were many concerns at the beginning of 1989 about the performance of the U.S. economy, HP experienced solid growth in the U.S. as net revenue rose 17 percent to $5.6 billion following growth of 16 percent in 1988. Net revenue from customers outside the U.S. grew 25 percent to $6.3 billion after an increase of 28 percent in the prior year. The international net revenue growth in 1989 was excellent in both Europe and HP's other major international sales region which includes the Asia-Pacific area, Canada and Latin America. International revenue growth was only minimally impacted by the changing value of the U.S. dollar. As illustrated in the graph on page 26, at the end of 1989 the value of the U.S. dollar relative to major foreign currencies was only slightly higher than its corresponding value at the end of 1988.

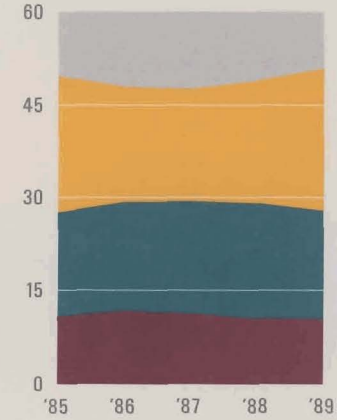
Equipment sales increased 22 percent in both 1989 and 1988 while service revenue grew 18 percent and 20 percent in 1989 and 1988, respectively. Demand was particularly strong for the company's personal computers, engineering workstations and peripheral products such as office system and workstation printers. In addition, new product shipments in the medical group were excellent in the second half of 1989, contributing to the increase in equipment sales. Detailed information on orders and net revenue by groupings of similar products and services is presented on page 42 of this report.

1989 was an outstanding year for new products in most of HP's major businesses. The company's computer business continued to expand its line of HP Precision Architecture technical minicomputers with the introduction of a variety of machines including new entry-level models. HP also introduced a series of new minicomputers for commercial applications which feature an enhanced release of the HP MPE/XL operating system. In October, the company was the first in the industry to announce a personal computer, the HP Vectra 486 PC, based on the Intel i486 microprocessor and Extended Industry Standard

U.S. Dollar Relative to Major Foreign Currencies
Fiscal 1980 equals 1.00



Costs and Expenses
As a percentage of net revenue



Cost of equipment sold and services

Selling, general and administrative

Research and development

Architecture. In addition, the Apollo division introduced a number of products including a powerful personal workstation, the Apollo Series 2500. HP also added several products to its family of printers, including the HP LaserJet IIP, a desktop printer which set new price/performance standards for the industry, and the HP DeskWriter inkjet printer. In other parts of HP's business, the company introduced a variety of new products such as a vascular imaging system and a clinical information system, a benchtop atomic-emission detector, and new families of low-cost digitizing oscilloscopes and portable spectrum analyzers.

Costs and expenses as a percentage of net revenue are presented in the following table:

For the years ended October 31	1989	1988	1987
Cost of equipment sold and services	51.2	49.2	47.8
Research and development	10.7	10.7	11.5
Selling, general and administrative	27.9	29.1	29.5

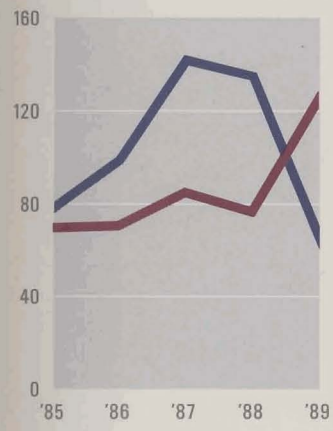
During 1989, cost of equipment sold and services as a percentage of net revenue increased 2.0 percentage points after a 1.4 percentage point increase in 1988. The 1989 increase reflects continued shifts in product and distribution channel mix. As previously mentioned, HP's growth in net revenue continues to be significantly driven by personal computing products, such as peripherals and personal computers. These products are distributed principally through dealers and other value-added resellers who generally receive higher trade discounts than the company average, thereby increasing cost of sales as a percentage of net revenue. This effect, however, was somewhat mitigated late in the year by a change in product mix. During the fourth quarter, improved performance was seen in higher margin products such as high-end minicomputers and certain medical products. Additionally, the company's ongoing efforts to improve its cost structure by maximizing manufacturing efficiency continue to favorably impact cost of sales.

However, it remains a key objective of the company to further offset the decline in its gross margin by managing operating expense growth. Some progress was made in this regard in 1989 as the 2.0 percentage point increase in cost of equipment sold and services as a percentage of net revenue was partially offset by a 1.2 percentage point decline in operating expenses.

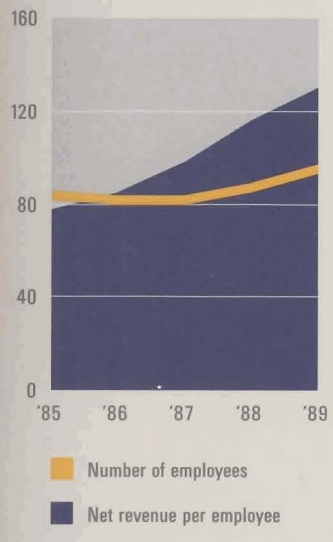
Research and development expense increased 20 percent in 1989 to $1.3 billion after 14 percent growth in 1988. As a percentage of net revenue, research and development expense remained unchanged from the prior year. The increase in expenditures in 1989 reflects HP's long-standing commitment to technical innovation. This is considered vital to the company's future growth and position in a global marketplace that continues to become increasingly competitive and complex. Again in 1989, over half of HP's orders were for products introduced in the preceding three years.

Selling, general and administrative expense as a percentage of net revenue declined 1.2 percentage points in 1989 after a decrease of .4 percentage points in 1988. The current year decline reflects the favorable impact resulting from increased sales of products through dealer and other value-added channels which generally have lower associated selling expenses. The decline also reflects the result of cost curtailment efforts which restricted the growth of general and administrative expenses. Although selling, general and administrative

Interest and Other Income (Expense)
In millions



Employees and Net Revenue per Employee
In thousands



expense declined as a percentage of net revenue, expenditures increased 16 percent in 1989 to $3.3 billion compared to growth of 20 percent in 1988. The increase in 1989 was principally attributed to selling expenses incurred in connection with higher sales volume along with increased product promotion and advertising incurred to enhance sales growth.

HP will continue to work on improving its operating profit margin by managing operating expenses and hiring. During the second half of the year, the company instituted controls on external hiring which resulted in the total employment level remaining unchanged during the fourth quarter.

Interest income and other income (expense) decreased to $65 million in 1989 from $135 million and $142 million reported in 1988 and 1987, respectively. The amount decreased in 1989 primarily because of reductions in interest income as the company's cash balances were substantially lower during 1989. Lower cash balances resulted primarily from the significant purchases of HP stock made in 1988 under the company's stock repurchase program. Interest income and other income (expense) in 1989 was also affected by $17 million of goodwill amortization associated with the acquisition of Apollo and a $9 million charge for costs incurred as a result of the recent earthquake in the San Francisco Bay Area.

Interest expense increased to $126 million in 1989 from $77 million reported in 1988 and $85 million in 1987. The increase in 1989 reflects higher levels of short-term borrowings outstanding during the second half of the year principally utilized to fund the acquisition of Apollo and to meet working capital requirements.

The company's effective tax rate was 28.0 percent in 1989 compared to 28.5 percent in 1988 and 33.0 percent in 1987. The significant decline in the effective tax rate in 1988, when compared to 1987, was attributed mainly to a reduction in the U.S. federal statutory income tax rate.

The company will be required to adopt Statement of Financial Accounting Standards No. 96 (SFAS 96), "Accounting for Income Taxes," by fiscal 1993. As more fully described in the Notes to Consolidated Financial Statements, implementation of SFAS 96 is expected to result in a modest benefit to reported earnings in the year of adoption.

Net earnings increased 2 percent in 1989 to $829 million compared to $816 million and $644 million in 1988 and 1987, respectively. As a percentage of net revenue, net earnings decreased to 7.0 percent in 1989 from 8.3 percent in 1988 and 8.0 percent in 1987. The company's lower net profit margin was primarily attributed to a lower operating margin, lower interest income, higher interest expense and the impact of the Apollo acquisition. Net earnings per share increased 5 percent in 1989 to $3.52 compared to $3.36 and $2.50 in 1988 and 1987, respectively. Net earnings per share increased at a greater rate than net earnings primarily as a result of purchases of HP common stock under the company's share repurchase program which reduced the level of shares outstanding.

During 1989, HP began to see the benefits of actions undertaken to improve performance. The continuation of these actions and the goal of improving operating profit margin are HP's top priorities for 1990. With the numerous product introductions in 1989 and a strong worldwide organization, the company is in an advantageous position to capitalize on opportunities across a broad range of market segments.

Consolidated Balance Sheet

Hewlett-Packard Company and Subsidiaries

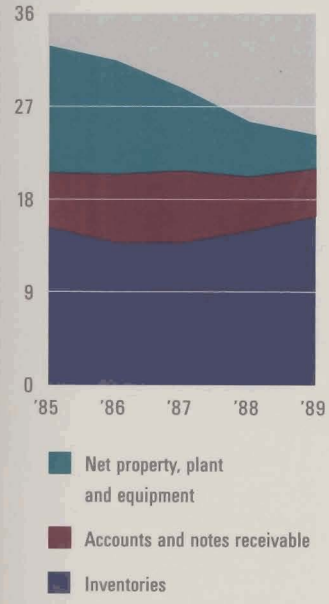
October 31 In millions except par value and number of shares	1989	1988
Assets		
Current assets:		
Cash and cash equivalents	$ 906	$ 814
Short-term investments	20	118
Accounts and notes receivable	2,494	1,982
Inventories:		
Finished goods	966	680
Purchased parts and fabricated assemblies	981	798
Other current assets	364	170
Total current assets	5,731	4,562
Property, plant and equipment:		
Land	337	320
Buildings and leasehold improvements	2,315	2,052
Machinery and equipment	2,330	1,958
	4,982	4,330
Accumulated depreciation and amortization	(2,089)	(1,814)
	2,893	2,516
Long-term receivables and other assets	1,451	780
	$10,075	$7,858
Liabilities and shareholders' equity		
Current liabilities:		
Notes payable and short-term borrowings	$ 1,341	$ 539
Accounts payable	642	460
Employee compensation and benefits	748	635
Taxes on earnings	309	391
Deferred revenues	256	202
Other accrued liabilities	447	362
Total current liabilities	3,743	2,589
Long-term debt	474	392
Other liabilities	164	157
Deferred taxes on earnings	248	187
Shareholders' equity:		
Preferred stock, $1 par value (authorized: 300,000,000 shares; issued: none)	–	–
Common stock and capital in excess of $1 par value (authorized: 600,000,000 shares; issued and outstanding: 237,644,000 in 1989 and 234,218,000 in 1988)	459	234
Retained earnings	4,987	4,299
Total shareholders' equity	5,446	4,533
	$10,075	$7,858

The accompanying notes are an integral part of these financial statements.

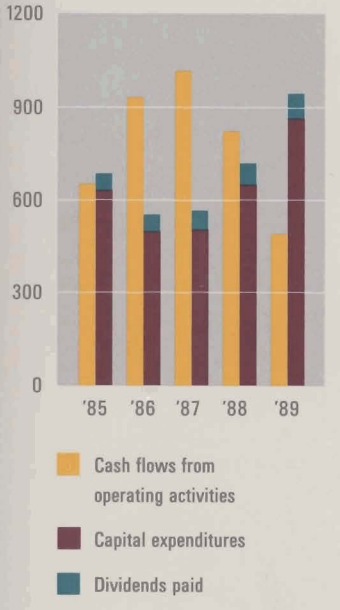
Financial Review

Hewlett-Packard Company and Subsidiaries
Unaudited

Asset Management
As a percentage of net revenue



Selected Cash Flows
In millions



Financial Condition and Liquidity

HP's financial position remains strong with cash and cash equivalents, and short-term investments of $926 million at October 31, 1989. Corresponding balances were $932 million and $2.8 billion at the end of 1988 and 1987, respectively.

Cash generated from operating activities was $496 million in 1989 compared to $823 million in 1988 and $1.0 billion in 1987. The decline in 1989 was principally attributed to higher payments of certain income taxes which were deferred in prior years. Inventory growth in 1989 was again a significant component of cash utilized in the company's operations. However, excluding Apollo's 1989 year-end inventory balance, the rate of growth decreased substantially to 24 percent compared to the 32 percent inventory growth rate experienced in 1988. This decrease reflects the company's ongoing effort to minimize its investment in inventory while retaining the flexibility to respond to increases in product demand.

Capital expenditures were $857 million in 1989, $648 million in 1988 and $507 million in 1987. Expenditures for 1990, while expected to exceed those of 1989, are planned to grow at a slower pace than the 32 percent growth reported in 1989. The company continues to invest in capital improvements in amounts sufficient to support future growth, enhance operating processes and maintain the highest standards of product quality.

On May 18, 1989, the company completed its cash tender offer for substantially all of the outstanding shares of Apollo for $500 million. The acquisition, financed through a combination of working capital and short-term borrowings, was accounted for under the purchase method. The excess of the acquisition cost over the fair market value of net assets acquired was approximately $420 million and is being amortized on a straight-line basis over 10 years. The unamortized balance at the end of 1989 is included in other assets in the company's consolidated balance sheet.

Notes payable and short-term borrowings, excluding those acquired in the purchase of Apollo, increased $799 million in 1989. The increased borrowings mostly occurred in the second half of the year and, as previously mentioned, were primarily utilized to fund the acquisition of Apollo and to meet working capital requirements. The new borrowings were in the form of short-term commercial paper.

The purchase of HP common stock pursuant to the company's ongoing stock repurchase program, the most significant use of funds in 1988, decreased dramatically. In 1989, HP purchased and retired 2.8 million shares of its common stock for an aggregate price of $140 million, with the majority of these repurchases occurring in the first quarter. In the prior year, the company acquired 29.6 million shares for an aggregate price of $1.6 billion. The company has Board of Directors' authorization for additional stock repurchase expenditures of up to $102 million based on certain price and volume criteria, but presently does not anticipate making any major purchases in 1990.

HP employment increased to 95,000 employees at the end of 1989 from 87,000 and 82,000 at the end of 1988 and 1987, respectively. Approximately 4,000 employees were added to HP's workforce as a result of the Apollo acquisition. Other than the impact of Apollo, the company increased its personnel in both the manufacturing and operating expense areas.

Consolidated Statement of Cash Flows
Hewlett-Packard Company and Subsidiaries

For the years ended October 31 In millions	1989	1988	1987
Cash flows from operating activities:			
Net earnings	$ 829	$ 816	$ 644
Adjustments to reconcile net earnings to cash provided by operating activities:			
Depreciation and amortization	462	373	342
U.S. federal deferred taxes on earnings	(6)	(189)	97
Changes in assets and liabilities:			
Accounts and notes receivable	(385)	(305)	(230)
Inventories	(324)	(361)	(136)
Accounts payable	134	118	76
Taxes on earnings	(130)	192	65
Other current assets and liabilities	97	218	175
Other, net	(181)	(39)	(12)
	496	823	1,021
Cash flows from investing activities:			
Investment in property, plant and equipment	(857)	(648)	(507)
Disposition of property, plant and equipment	120	107	73
Purchase of short-term investments	(58)	(57)	(427)
Maturities of short-term investments	174	466	469
Purchase of Apollo Computer Inc., net of cash acquired	(486)	–	–
Other, net	(45)	(139)	6
	(1,152)	(271)	(386)
Cash flows from financing activities:			
Increase (decrease) in notes payable and short-term borrowings	799	(465)	682
Issuance of long-term debt	31	30	42
Repayment of current maturities of long-term debt	(95)	(117)	(66)
Issuance of common stock under employee stock plans	223	211	191
Repurchase of common stock	(140)	(1,569)	(220)
Dividends	(85)	(69)	(60)
Other, net	15	10	7
	748	(1,969)	576
Increase (decrease) in cash and cash equivalents	92	(1,417)	1,211
Cash and cash equivalents at beginning of year	814	2,231	1,020
Cash and cash equivalents at end of year	$ 906	$ 814	$2,231

The accompanying notes are an integral part of these financial statements.

Consolidated Statement of Shareholders' Equity

Hewlett-Packard Company and Subsidiaries

In millions except number of shares in thousands	Common stock		Retained earnings	Total
	Number of shares	Par value and capital in excess of par		
Balance October 31, 1986	256,092	$712	$3,662	$4,374
Employee stock plans:				
Shares issued	6,051	284	–	284
Shares purchased	(4,892)	(220)	–	(220)
Dividends	–	–	(60)	(60)
Net earnings	–	–	644	644
Balance October 31, 1987	257,251	776	4,246	5,022
Employee stock plans:				
Shares issued	6,536	333	–	333
Shares purchased	(29,569)	(875)	(694)	(1,569)
Dividends	–	–	(69)	(69)
Net earnings	–	–	816	816
Balance October 31, 1988	234,218	234	4,299	4,533
Employee stock plans:				
Shares issued	6,208	309	–	309
Shares purchased	(2,782)	(84)	(56)	(140)
Dividends	–	–	(85)	(85)
Net earnings	–	–	829	829
Balance October 31, 1989	237,644	$459	$4,987	$5,446

The accompanying notes are an integral part of these financial statements.

Summary of Significant Accounting Policies

Principles of consolidation
The consolidated financial statements include the accounts of Hewlett-Packard Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Revenue recognition
Revenue from equipment sales is recognized at the time the equipment is shipped. Services revenue is recognized over the contractual period or as services are performed.

Taxes on earnings
Income tax expense is based on pretax financial accounting income and includes deferred taxes for the effects of timing differences between financial accounting and taxable earnings.

Net earnings per share
Net earnings per share is computed based on a method which approximates the use of weighted-average shares outstanding during the year; shares used in the computation were 235,471,000 in 1989, 243,258,000 in 1988 and 257,251,000 in 1987. Outstanding stock options considered to be common stock equivalents have not been included because the effect would be immaterial.

Short-term investments
Short-term investments principally comprise cash invested in certificates of deposit, temporary money market instruments and tax-exempt notes, and are stated at cost which approximates market.

Inventories
Inventories are valued at standard costs which approximate actual costs computed on a first-in, first-out basis, not in excess of market.

Property, plant and equipment
Property, plant and equipment are stated at cost. Additions, improvements and major renewals are capitalized. Maintenance, repairs and minor renewals are expensed as incurred. Depreciation is provided using accelerated methods, principally over the following useful lives: buildings and improvements, 15 to 40 years; and machinery and equipment, three to 10 years. Amortization of leasehold improvements is provided using the straight-line method over the life of the lease or the asset, whichever is shorter.

Foreign currency translation
The company uses the U.S. dollar as its functional currency. Foreign currency assets and liabilities are translated into U.S. dollars at end-of-period exchange rates except for inventories, prepaid expenses, and property, plant and equipment, which are translated at historical exchange rates. Revenues and expenses are translated at average exchange rates in effect during the year except for those expenses related to balance sheet amounts that are translated at historical exchange rates. Gains or losses from foreign currency translation are included in net earnings.

Statement of Cash Flows

The company adopted Statement of Financial Accounting Standards No. 95 (SFAS 95), "Statement of Cash Flows," in fiscal 1988. In accordance with SFAS 95, the company has classified marketable securities and time deposits as cash equivalents if the original maturity of such investments is three months or less.

The company paid income taxes of $484 million in 1989, $335 million in 1988 and $151 million in 1987. For the same periods, the company paid interest of $108 million, $70 million and $81 million, respectively. The effect of foreign currency exchange rate fluctuations on cash balances held in foreign currencies was not material. Information about noncash investing activities related to the acquisition of Apollo Computer Inc. is included in the Acquisition note below.

Accounting and Reporting Changes

Consolidation of Hewlett-Packard Finance Company

The company implemented Statement of Financial Accounting Standards No. 94 (SFAS 94), "Consolidation of All Majority-owned Subsidiaries," in fiscal 1989. With the adoption of SFAS 94, the company consolidated the accounts of Hewlett-Packard Finance Company (HPFC), a wholly-owned subsidiary previously accounted for under the equity method, with those of the company. The change resulted in an increase in consolidated assets and liabilities but did not have a material effect on the company's financial position. Since HPFC was previously accounted for under the equity method, the change did not affect net earnings. Prior years' consolidated financial information has been restated to reflect this change for comparative purposes.

Classification of profit-sharing and retirement costs

In fiscal 1989, profit-sharing and retirement costs, previously included in administrative and general expense, are reported in the statement of earnings categories according to the functional areas in which they are incurred. Prior years' consolidated financial information has been restated on a comparative basis to reflect this change, which did not effect net earnings.

Financial presentation

In addition to the above changes, certain amounts in the consolidated financial statements have been reclassified to conform to the 1989 presentation.

Acquisition

On May 18, 1989, the company completed its cash tender offer for substantially all of the outstanding common shares of Apollo Computer Inc. (Apollo) for $500 million, acquiring assets with a fair market value of $790 million and assuming liabilities of $290 million. Apollo designs, manufactures, markets and services network-based workstations and open computing products.

The acquisition, financed through a combination of working capital and short-term borrowings, was accounted for under the purchase method. Accordingly, the acquisition cost has been allocated to Apollo's assets and liabilities based upon their estimated fair market values at the date of acquisition. These estimates are subject to change upon finalization of the valuations. The excess of the acquisition cost over the fair market value of net assets acquired was $420 million and is being amortized on a straight-line basis over 10 years. For accounting purposes, June 1, 1989 was established as the effective date of the merger. The accompanying consolidated financial statements include the results of Apollo subsequent to the effective date.

Unaudited pro forma consolidated results of operations for the years ended October 31, 1989 and 1988, assuming the acquisition had occurred at the beginning of each respective year, are as follows: net revenue of $12.3 billion and $10.5 billion, net earnings of $784 million and $754 million, and net earnings per share of $3.33 and $3.10, respectively. The pro forma figures are not necessarily indicative of results which would have been achieved had the acquisition occurred at the beginning of the periods presented or of future results of the combined operations.

Taxes on Earnings

The provision for taxes comprises the following:

In millions	1989	1988	1987
U.S. federal taxes:			
Current	$ 70	$230	$(15)
Deferred	(6)	(189)	97
State taxes	25	51	37
Non-U.S. taxes	233	234	199
	$322	$326	$318

The difference between the U.S. federal statutory income tax rate and the company's effective tax rate is as follows:

	1989	1988	1987
U.S. federal statutory income tax rate	34.0%	34.0%	42.0%
State income taxes, net of federal tax benefit	1.4	2.9	2.2
Research and development tax credits	(1.8)	(1.8)	(2.0)
FSC tax benefit	(1.1)	(2.5)	(1.3)
Lower rates in other jurisdictions, net	(2.8)	(3.7)	(6.6)
Other, net	(1.7)	(.4)	(1.3)
	28.0%	28.5%	33.0%

Deferred federal taxes result from differences in the timing of revenue and expense recognition for tax and financial reporting purposes. Included in these differences are amounts relating to intercompany profit eliminations, the effects of which resulted in decreased deferred taxes of $34 million and $21 million in 1989 and 1988, respectively. These differences also include the effects of deferred payment contracts which resulted in decreased deferred taxes of $217 million in 1988 and increased deferred taxes of $90 million in 1987. There are no other individually significant timing differences.

After allocating eliminations and corporate items, earnings before taxes of U.S. and non-U.S. operations are as follows:

In millions	1989	1988	1987
U.S. operations, including Puerto Rico	$ 432	$ 593	$442
Non-U.S. operations	719	549	520
	$1,151	$1,142	$962

The company has not provided for U.S. federal income and foreign withholding taxes on $904 million of non-U.S. subsidiaries' undistributed earnings as of October 31, 1989 because such earnings are intended to be reinvested indefinitely. If these earnings were distributed, foreign tax credits should become available under current law to reduce or eliminate the resulting U.S. income tax liability. Where excess cash has accumulated in the company's non-U.S. subsidiaries and it is advantageous for tax or foreign exchange reasons, subsidiary earnings are remitted.

As a result of certain employment and capital investment actions undertaken by the company, income from manufacturing activities in certain countries is subject to reduced tax rates, and in some cases is wholly exempt from taxes, for years through 2002. The income tax benefits attributable to the tax status of these subsidiaries are estimated to be $88 million, $57 million and $43 million for 1989, 1988 and 1987, respectively.

Federal income tax returns of the company have been examined through 1983 by the Internal Revenue Service (IRS) and settled through 1979. The IRS has not commenced its examination of returns for years subsequent to 1983. The company believes that adequate accruals have been provided for all years.

In December 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96 (SFAS 96), "Accounting for Income Taxes." The company will be required to adopt SFAS 96 by the first quarter of fiscal 1993. Under the new standard, deferred taxes are computed based on enacted tax rates for the years in which such taxes are scheduled to be payable or refundable, subject to certain limitations on the recognition of deferred tax benefits. The company expects to recognize a modest benefit to reported earnings upon implementation of SFAS 96, provided current income tax rates remain at their present levels. This implementation benefit is expected to result from the reduction of certain deferred tax liabilities currently recorded at tax rates which are higher than those presently in effect.

Shareholders' Equity

Employee Stock Purchase Plan

Eligible company employees may contribute generally up to 10 percent of their base compensation to the quarterly purchase of company stock under the Employee Stock Purchase Plan. Under this plan, employees contribute 75 percent and the company contributes 25 percent of a formula stock price, which is based on average market prices during the preceding quarter. At October 31, 1989, 78,000 employees were eligible to participate and 55,000 employees were participants in the plan.

Incentive compensation plans

The company has three principal stock option plans, adopted in 1974, 1979 and 1985. All plans permit options granted to qualify as "Incentive Stock Options" under the Internal Revenue Code. Options are granted at prices which equal the fair market value on the date of grant. The majority of options granted through 1986 vested at a rate of 25 percent in each of the first two years and at 50 percent in the third year from the date of grant. Options granted subsequent to 1986 generally vest at a rate of 25 percent per year over a period of four years from the date of grant. The plans provide for the granting of stock appreciation rights with respect to options granted to officers.

The following table summarizes option activity during 1989:

Thousands except price per share amounts	Options	Price per share
Outstanding at October 31, 1988	10,950	$ 12-63
Granted	2,836	47-57
Conversion of Apollo options*	204	11-116
Exercised	(1,014)	12-49
Cancelled	(177)	15-63
Outstanding at October 31, 1989	12,799	$11-116

*In accordance with the merger agreement associated with the acquisition of Apollo Computer Inc., Apollo employees were given the opportunity to convert their outstanding stock options into options to purchase HP stock. The conversion ratio was based upon equivalent share values as of the acquisition date, May 18, 1989.

At October 31, 1989, options to purchase 7,213,000 shares were exercisable at prices ranging from $11 to $116 per share. Shares available for option grants at October 31, 1989 and 1988 were 946,000 and 3,775,000, respectively. Approximately 41,000 employees were considered eligible to receive stock options in fiscal 1989. There were approximately 14,000 employees holding options under one or more of the option plans as of October 31, 1989.

Under the 1985 Incentive Compensation Plan, certain key employees may be granted cash or restricted stock awards. Cash and restricted stock awards are independent of option grants and are subject to restrictions considered appropriate by the company's Executive Compensation and Stock Option Committee. The majority of the shares of restricted stock outstanding at October 31, 1989 are subject to forfeiture if employment terminates prior to five years from the date of grant. During that period, ownership of the shares cannot be transferred.

Restricted stock has the same dividend and voting rights as other common stock and is considered to be currently issued and outstanding. The cost of the awards, determined as the fair market value of the shares at the date of grant, is expensed ratably over the period the restrictions lapse. Such expense amounted to $20 million, $17 million and $10 million in 1989, 1988 and 1987, respectively. At October 31, 1989 and 1988, the company had 2,403,000 and 2,236,000 shares, respectively, of restricted stock outstanding.

Shares reserved

The company has reserved shares for future issuance under the employee stock plans. At October 31, 1989 and 1988, 19,237,000 and 25,384,000 shares, respectively, were reserved.

Stock repurchase program

Under the company's stock repurchase program, shares of HP common stock are periodically purchased by an independent broker to meet future employee stock plan requirements. In 1989, 2,782,000 shares were repurchased for an aggregate purchase price of $140 million. In 1988, the company acquired 29,569,000 shares for an aggregate price of $1,569 million. At October 31, 1989, HP has authorization for an aggregate of $102 million in future repurchases under this program based on certain price and volume criteria.

Retirement Plans

Pension and profit-sharing plans

Substantially all of the company's employees are covered under various pension and deferred profit-sharing retirement plans. The worldwide pension and deferred profit-sharing costs were $104 million in 1989, $111 million in 1988 and $75 million in 1987.

U.S. employees are provided retirement benefits by the U.S. Deferred Profit-Sharing Plan and the U.S. Supplemental Pension Plan. The U.S. Deferred Profit-Sharing Plan is a defined contribution plan that provides the vast majority of retirement benefits. The plan is funded solely by the company through an annual contribution based upon the company's adjusted U.S. net income, as defined in the plan agreement. Assets of the plan are held in trust for the sole benefit of employees. Expense for the U.S. Deferred Profit-Sharing Plan was $67 million in 1989, $70 million in 1988 and $50 million in 1987. The U.S. Supplemental Pension Plan is a defined benefit plan that provides for any excess of defined minimum benefits over the benefits available from the U.S. Deferred Profit-Sharing Plan. The amount of the benefit is computed based upon the employee's highest average pay rate and length of service, reduced by the annuity value to which the employee is entitled under the U.S. Deferred Profit-Sharing Plan.

The combined status of the U.S. Deferred Profit-Sharing and U.S. Supplemental Pension plans is as follows:

In millions	1989	1988
Fair value of plan assets	$1,565	$1,297
Retirement benefit obligation	$1,327	$1,097

Employees outside of the U.S. generally receive retirement benefits under various defined benefit and defined contribution plans based upon such factors as years of service and employee compensation levels. It is the company's practice to fund these pension costs to the extent they are tax deductible.

The funded status of the U.S. and non-U.S. defined benefit plans is as follows:

	U.S. supplemental defined benefit plan		Non-U.S. defined benefit plans	
In millions	1989	1988	1989	1988
Vested benefit obligation	$ (3)	$ (2)	$(192)	$(173)
Accumulated benefit obligation	$ (4)	$ (3)	$(200)	$(180)
Fair value of plan assets	$263	$ 224	$ 385	$ 333
Projected benefit obligation	(25)	(24)	(385)	(352)
Excess of plan assets over projected benefit obligation	238	200	–	(19)
Unrecognized net experience (gain) loss	(40)	(19)	2	22
Unrecognized net transition asset*	(99)	(108)	(22)	(26)
Prepaid (accrued) pension costs	$ 99	$ 73	$ (20)	$ (23)

*Amortized over 15 years for the U.S. plan and over periods ranging from 12 to 20 years for non-U.S. plans.

Plan assets consist primarily of listed stocks and bonds for the U.S. plans and listed stocks, bonds and cash surrender value life insurance policies for the non-U.S. plans.

The company's worldwide net pension and deferred profit-sharing costs comprise the following:

	U.S. plans			Non-U.S. plans		
In millions	1989	1988	1987	1989	1988	1987
Service cost–benefits earned during the period	$ 2	$ 2	$ 1	$38	$37	$28
Interest cost on projected benefit obligation	2	1	1	24	22	17
Actual investment return on plan assets	(40)	(22)	(13)	(34)	(25)	(6)
Net amortization and deferral	10	(7)	(15)	6	–	(15)
Net pension charge (credit) for defined benefit plans	(26)	(26)	(26)	34	34	24
Pension and deferred profit-sharing costs for other plans	67	70	50	29	33	27
	$41	$44	$24	$63	$67	$51

The assumptions used to measure the projected benefit obligations and to compute the expected long-term return on assets for the company's defined benefit plans are as follows:

	1989	1988	1987
U.S. supplemental defined benefit plan:			
Discount rate	8.5%	8.5%	8.0%
Average increase in compensation levels	7.0%	7.0%	7.0%
Expected long-term return on assets	9.0%	9.0%	9.0%
Non-U.S. defined benefit plans:			
Discount rate	5.0% to 11.5%	4.5% to 10.0%	4.5% to 13.5%
Average increase in compensation levels	4.0% to 9.0%	3.0% to 9.0%	3.5% to 9.0%
Expected long-term return on assets	5.5% to 13.0%	5.0% to 11.5%	5.0% to 12.0%

TaxCAP and other benefits

Employees of the company and certain of its subsidiaries may participate in the Tax Saving Capital Accumulation 401(k) Plan (TaxCAP) which was established as a supplemental retirement program. Under the TaxCAP program, the company contributes one dollar for every three dollars contributed by employees. Combined Employee Stock Purchase Plan and TaxCAP contributions by an employee cannot exceed 12 percent of the employee's annual base compensation. At October 31, 1989, 42,000 employees were participating in TaxCAP out of the 55,000 who were eligible.

In addition to providing pension benefits, the company currently provides certain healthcare and life-insurance benefits for retired employees. Substantially all of the company's U.S. employees could become eligible for these benefits. The cost of such benefits, which is recognized as expense as claims are paid, was $6 million in 1989, $7 million in 1988 and $3 million in 1987.

Notes Payable and Short-term Borrowings

Notes payable and short-term borrowings comprise the following:

In millions	1989	1988
Notes payable to banks	$ 191	$436
Commercial paper	1,099	27
Current maturities of long-term debt	51	76
	$1,341	$539

The company has unused lines of credit of $648 million at October 31, 1989. These lines of credit provide for borrowings on a worldwide basis and generally do not require commitment fees.

Geographic Area Information

The company operates in a single industry segment: the design, manufacture and service of measurement and computation products and systems.

Net revenue, earnings from operations and identifiable assets, classified by the major geographic areas in which the company operates, are as follows:

In millions	1989	1988	1987
Net revenue			
United States:			
Unaffiliated customer sales	$ 5,561	$4,763	$4,122
Interarea transfers	2,634	2,064	1,596
	8,195	6,827	5,718
Europe:			
Unaffiliated customer sales	4,131	3,304	2,667
Interarea transfers	271	250	206
	4,402	3,554	2,873
Other areas:			
Unaffiliated customer sales	2,207	1,764	1,301
Interarea transfers	601	457	313
	2,808	2,221	1,614
Eliminations	(3,506)	(2,771)	(2,115)
	$11,899	$9,831	$8,090
Earnings from operations			
United States	$ 881	$ 858	$ 729
Europe	359	235	310
Other areas	379	325	178
Eliminations and corporate	(407)	(334)	(312)
	$ 1,212	$1,084	$ 905
Identifiable assets			
United States	$ 5,875	$4,668	$5,056
Europe	2,532	1,998	1,577
Other areas	1,365	986	839
Eliminations and corporate	303	206	1,075
	$10,075	$7,858	$8,547

Net revenue from sales to unaffiliated customers is based on the location of the customer. Interarea transfers are sales among HP affiliates principally made at market price, less an allowance primarily for subsequent manufacturing and/or marketing costs. Earnings from operations and identifiable assets are classified based on the location of the company's facilities.

Identifiable corporate assets, which are net of eliminations in the table on page 40, comprise primarily cash, property, plant and equipment, and other assets, and aggregate $2,136 million in 1989, $1,694 million in 1988 and $3,040 million in 1987.

Commitments

The company leases certain real and personal property. Minimum commitments under these operating leases are $138 million for 1990, $114 million for 1991, $83 million for 1992, $58 million for 1993, $37 million for 1994 and $244 million for 1995 through 2061. Certain leases require the company to pay property taxes, insurance and routine maintenance and include escalation clauses. Rent expense was $180 million in 1989, $142 million in 1988 and $134 million in 1987.

At October 31, 1989, the company had purchase commitments for plant site acquisition, facility construction and related machinery and equipment aggregating $403 million.

Orders and Net Revenue by Groupings of Similar Products and Services

Hewlett-Packard Company and Subsidiaries
Unaudited

For the years ended October 31 In millions	1989	1988	1987
Orders			
Measurement, design, information and manufacturing equipment and systems	$ 4,741	$ 3,900	$3,371
Peripherals and network products	3,564	2,809	2,153
Service for equipment, systems and peripherals	2,175	1,875	1,560
Medical electronic equipment and service	854	724	652
Analytical instrumentation and service	533	476	396
Electronic components	293	286	247
	$12,160	$10,070	$8,379
Net revenue			
Measurement, design, information and manufacturing equipment and systems	$ 4,631	$ 3,839	$3,256
Peripherals and network products	3,486	2,727	2,059
Service for equipment, systems and peripherals	2,157	1,855	1,540
Medical electronic equipment and service	807	688	618
Analytical instrumentation and service	535	456	388
Electronic components	283	266	229
	$11,899	$ 9,831	$8,090

The table above provides supplemental information showing orders and net revenue by groupings of similar products and services. The groupings are as follows:

Measurement, design, information and manufacturing equipment and systems
Equipment and systems (hardware and software) used for design, manufacturing, office automation and information processing; general-purpose instruments and computers; and handheld calculators.

Peripherals and network products
Printers, plotters, magnetic disc and tape drives, terminals and network products.

Service for equipment, systems and peripherals
Support and maintenance services, parts and supplies related to design and manufacturing systems, office and information systems, general-purpose instruments and computers, peripherals and network products.

Medical electronic equipment and service
Products that perform patient monitoring, diagnostic, therapeutic and data-management functions; application software; support and maintenance services; and hospital supplies.

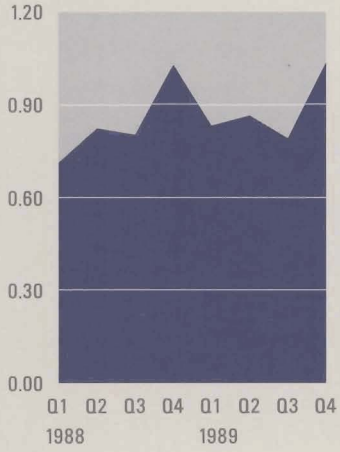
Analytical instrumentation and service
Gas and liquid chromatographs, mass spectrometers and spectrophotometers used to analyze chemical compounds; and support and maintenance services.

Electronic components
Microwave semiconductor and optoelectronic devices that are sold primarily to manufacturers for incorporation into electronic products.

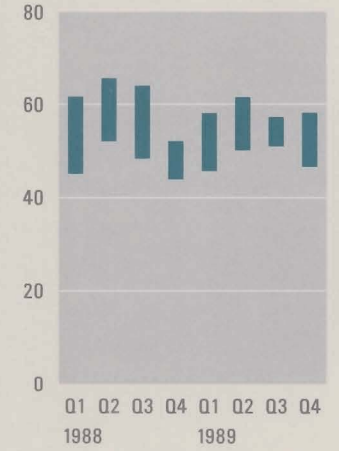
Quarterly Summary

Hewlett-Packard Company and Subsidiaries
Unaudited

Net Earnings per Share
In dollars



Range of Common Stock Prices
In dollars per share

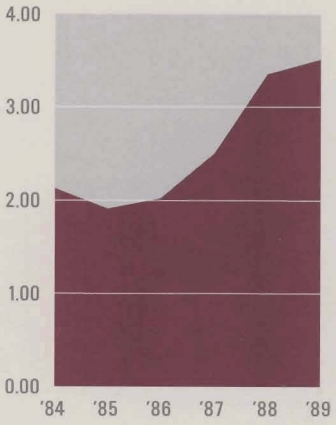


For the three months ended In millions except per share amounts	January 31	April 30	July 31	October 31
1989				
U.S. orders	$1,369	$1,373	$1,388	$1,547
International orders	1,644	1,605	1,632	1,602
Total orders	$3,013	$2,978	$3,020	$3,149
Net revenue	$2,657	$2,864	$3,001	$3,377
Cost of equipment sold and services	$1,327	$1,461	$1,557	$1,746
Earnings from operations	$ 279	$ 289	$ 258	$ 386
Net earnings	$ 193	$ 203	$ 187	$ 246
Net earnings per share	$ .83	$ .86	$ .79	$ 1.04
Cash dividends paid per share	$ .085	$ .085	$ .085	$ .105
Range of stock prices per share	$57⅞-45⅝	$61½-50⅛	$57¼-50⅞	$58⅛-46½
1988				
U.S. orders	$1,168	$1,139	$1,198	$1,275
International orders	1,272	1,348	1,329	1,341
Total orders	$2,440	$2,487	$2,527	$2,616
Net revenue	$2,192	$2,496	$2,434	$2,709
Cost of equipment sold and services	$1,054	$1,226	$1,200	$1,352
Earnings from operations	$ 233	$ 286	$ 250	$ 315
Net earnings	$ 179	$ 202	$ 192	$ 243
Net earnings per share	$ .71	$ .82	$ .80	$ 1.03
Cash dividends paid per share	$ .065	$ .065	$ .065	$ .085
Range of stock prices per share	$61⅜-44¾	$65½-52	$63⅞-48¼	$52-43¾

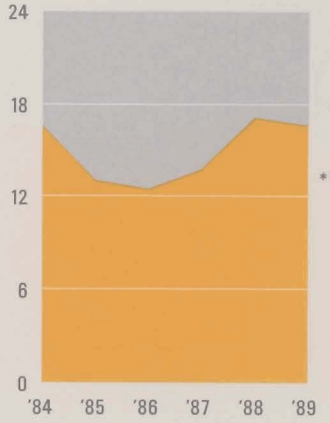
Selected Financial Data

Hewlett-Packard Company and Subsidiaries
Unaudited

Net Earnings per Share**
In dollars



Return on Average Shareholders' Equity**
Percent



For the years ended October 31 In millions except per share amounts in dollars and employees in thousands	1989	1988	1987	1986	1985	1984
U.S. orders	$ 5,677	$ 4,780	$4,262	$3,826	$3,662	$3,629
International orders	6,483	5,290	4,117	3,375	2,733	2,721
Total orders	$12,160	$10,070	$8,379	$7,201	$6,395	$6,350
Net revenue	$11,899	$ 9,831	$8,090	$7,102	$6,505	$6,044
Earnings from operations	$ 1,212	$ 1,084	$ 905	$ 752	$ 750	$ 814
Net earnings	$ 829	$ 816	$ 644	$ 516	$ 489	$ 665*
Per share:						
Net earnings	$ 3.52	$ 3.36	$ 2.50	$ 2.02	$ 1.91	$ 2.59*
Cash dividends	$ .36	$ .28	$ .23	$ .22	$ .22	$ .19
At year-end:						
Total assets	$10,075	$ 7,858	$8,547	$6,770	$5,959	$5,349
Employees	95	87	82	82	84	82

*Amounts include a one-time increase in net earnings of $118 million or 46 cents per share resulting from a 1984 DISC tax law change.

**The 1984 data has been adjusted to reflect the retroactive application of the 1984 DISC tax law change.

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Chief Executive Officer
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A paper and forest products manufacturer and distributor

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Trustee and Director for Medical Science
Lucille P. Markey Charitable Trust
A philanthropic foundation supporting basic medical science research

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Retired Chairman of the Board and
Chief Executive Officer
Chevron Corporation
Formerly Standard Oil Company of California

Walter B. Hewlett
Independent Researcher and
Director
Center for Computer Assisted
Research in the Humanities
A non-profit corporation

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Partner in the law firm of
Hufstedler, Miller, Kaus & Beardsley

George A. Keyworth II
Director of Research
Hudson Institute
A center for public policy research

Paul F. Miller, Jr.
Senior Partner
Miller, Anderson and Sherrerd
An investment management firm

Dean O. Morton
Executive Vice President and
Chief Operating Officer
Hewlett-Packard Company

David Packard
Chairman of the Board
Hewlett-Packard Company

David Woodley Packard
Chairman and President
Ibycus Corporation
Computer research systems for ancient languages

Donald E. Petersen
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Chief Executive Officer
Ford Motor Company

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Executive Vice President
Hewlett-Packard Company

Hicks B. Waldron
Retired Chairman and
Chief Executive Officer
Avon Products, Inc.
A beauty products company

T. A. Wilson
Chairman Emeritus
The Boeing Company
An aerospace company

John A. Young
President and
Chief Executive Officer
Hewlett-Packard Company

William R. Hewlett
Director Emeritus
Hewlett-Packard Company

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Young (Chair), Morton, Terry

Audit Committee
Hufstedler (Chair), Haynes, Petersen, Wilson

Employee Benefits Committee
Glaser (Chair), Fery, Walter Hewlett, Keyworth, Terry, Young

Executive Compensation and Stock Option Committee
Haynes (Chair), Glaser, Petersen, Waldron, Wilson

Investment Committee
Miller (Chair), Morton, David Woodley Packard, Waldron, Wilson

Nominating Committee
Glaser (Chair), Haynes, Hufstedler, Miller, David Packard, Young

Strategic Planning Committee
Wilson (Chair), Haynes, Walter Hewlett, Keyworth, Miller, David Woodley Packard

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John L. Doyle
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Business Development

Lewis E. Platt
Executive Vice President
Computer Products

William E. Terry
Executive Vice President
Measurement Systems

James L. Arthur
Senior Vice President and
General Manager
Worldwide Customer Support

Franco Mariotti
Senior Vice President and Director
European Operations

Alfred P. Oliverio
Senior Vice President

Robert P. Wayman
Senior Vice President and
Chief Financial Officer

Richard W. Anderson
Vice President and General Manager
Microwave and Communications
Group

Edward W. Barnholt
Vice President and General Manager
Electronic Instruments Group

Alan D. Bickell
Vice President and Director
Intercontinental Operations

Joel S. Birnbaum
Vice President and General Manager
Information Architecture Group

S. T. Jack Brigham III
Vice President Administration and
General Counsel

William F. Craven
Vice President and General Manager
Components Group

Harold E. Edmondson
Vice President and Director
Corporate Manufacturing

Richard A. Hackborn
Vice President and General Manager
Peripherals Group

Dieter Hoehn
Vice President and General Manager
Analytical Group

Benjamin L. Holmes
Vice President and General Manager
Medical Products Group

Michael C. Leavell
Vice President and Director
U.S. Field Operations

Franz Nawratil
Vice President and Director
European Marketing and Sales

William G. Parzybok, Jr.
Vice President and General Manager
Engineering and Manufacturing
Systems Group

Charles W. Richion
Vice President and Director,
U.S. Sales Operation

Willem P. Roelandts
Vice President and General Manager
Computer Systems Group

Frederic N. Schwettman
Vice President and General Manager
Circuit Technology Group

Raymond W. Cookingham
Controller

George F. Newman, Jr.
Treasurer

D. Craig Nordlund
Associate General Counsel and
Secretary

Ann O. Baskins
Assistant Secretary and
Corporate Counsel

New Officer

During 1989, Frederic
N. Schwettman, general manager
of the Circuit Technology Group,
was named a vice president
of the company.

Corporate Information

Corporate Offices

3000 Hanover Street
Palo Alto, California 94304
Telephone: (415) 857-1501

U.S. Operations

Manufacturing
Cupertino, Palo Alto, Rohnert Park, Roseville, San Diego, San Jose, Santa Clara, Santa Rosa and Sunnyvale, California

Colorado Springs, Fort Collins, Greeley and Loveland, Colorado

Boise, Idaho

Andover and Waltham, Massachusetts

Exeter, New Hampshire

Rockaway, New Jersey

Corvallis and McMinnville, Oregon

Avondale, Pennsylvania

Aguadilla, Puerto Rico

Everett, Spokane and Vancouver, Washington

Marketing
Region Headquarters:
North Hollywood, California

Atlanta, Georgia

Rolling Meadows, Illinois

Rockville, Maryland

HP Sales and Support Offices
Located in 160 cities throughout the United States*

International Operations

European Operations Headquarters:
Geneva, Switzerland

Intercontinental Operations Headquarters:
Palo Alto, California

European Manufacturing
Bristol and Pinewood, England

Grenoble and Lyon, France

Boeblingen and Waldbronn, Federal Republic of Germany

Livingston and South Queensferry, Scotland

Barcelona, Spain

Intercontinental Manufacturing
Ringwood, Australia

Campinas, Brazil

Waterloo, Canada

Beijing and Shenzhen, China

Bangalore, India

Hachioji, Japan

Seoul, Republic of Korea

Penang, Malaysia

Guadalajara, Mexico

Singapore

Taipei, Taiwan

European Marketing
Region Headquarters:

Pinewood, England

Evry, France

Bad Homburg, Federal Republic of Germany

Cernusco, Italy

Geneva, Switzerland

Intercontinental Marketing
Region Headquarters:

Melbourne, Australia

Toronto, Canada

Hong Kong

Mexico City, Mexico

Tokyo, Japan

HP Sales and Support Offices and Distributorships
Approximately 315 in 102 countries*

*A directory of sales and support locations can be obtained from the Public Relations Department, Hewlett-Packard Company corporate offices.

Shareholder Information

Annual Meeting of Shareholders
The annual meeting will be held Tuesday, February 27, 1990, at 2 p.m. at Hewlett-Packard's Cupertino site located at 19447 Pruneridge Avenue, Cupertino, California.

Annual Report/10-K Report
Publications of interest to current and potential HP investors are available upon request. These include annual and quarterly reports and the Form 10-K filed with the Securities and Exchange Commission. As a service to those with impaired vision, the HP 1989 Annual Report is available on audio cassette. This material can be obtained at no cost by contacting the Public Relations Department, Hewlett-Packard Company corporate offices.

Transfer Agent and Registrar
Harris Trust and Savings Bank
Corporate Trust Operations
Division, P.O. Box 755
Chicago, Illinois 60690
Telephone: (312) 461-4061

Common Stock, Dividend Policy
The company's stock is traded on the New York Stock Exchange and the Pacific, Tokyo, London, Frankfurt, Zurich and Paris exchanges.
Cash dividends have been paid each year since 1965. The current rate is $.105 per share per quarter.
At December 1, 1989, there were 72,400 shareholders of record.

Acknowledgements
The large photograph on pages 6-7 was taken at Hewlett-Packard's corporate offices in Palo Alto.

The large photograph on pages 8-9 was taken at the London offices of Building Design Partnership with the help of that company and Acropolis Design Systems of Coventry, England. These companies are involved in designing and building the UK terminal at Folkestone which will be part of the tunnel being built under the English Channel.

The large photograph on pages 10-11 was taken at the offices of Yokogawa Hewlett-Packard in Hachioji, Japan.

The large photograph on pages 12-13 was taken on the production line for computer terminals at HP's Grenoble Division in Grenoble, France.

The large photograph on pages 14-15 was taken at ERA Computers in San Francisco, California.

The large photograph on pages 16-17 was taken at HP's Customer Response Center in Mountain View, California.

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